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**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 24
Revenue Canada –
International Tax Directorate:
Human Resource Management

December 1998



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Report of the
Auditor General
of Canada
to the House of Commons

Chapter 24
Revenue Canada –
International Tax Directorate:
Human Resource Management



December 1998

This December 1998 Report comprises 11 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, September and December 1998 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

Chapter 24

Revenue Canada
International Tax Directorate
Human Resource Management

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Main Points

24.1 Revenue Canada's International Tax Directorate was established in November 1991. It is the focal point for all international tax issues (except legislative issues), with a view to enabling Revenue Canada to respond to them in a consistent and timely way.

24.2 A recent report of the Technical Committee on Business Taxation noted the following:

- In 1993, taxpayers reported to Revenue Canada \$248 billion in related-party cross-border transactions, \$166 billion of which were between related parties in Canada and the United States.
- In 1995, foreign direct investment into Canada was approximately \$170 billion, or 20 percent of assets held by Canadian businesses; and outbound foreign direct investment by Canadians was about \$140 billion, or 18 percent of total assets held by Canadian businesses.
- Even relatively small shifts in income allocated to Canada from related-party transactions have the potential to cause a significant change in the domestic revenue base.

24.3 In this complex and growing field, the Directorate requires staff who are highly skilled and who understand Canadian tax laws and tax laws in other jurisdictions.

24.4 Weaknesses in human resource management in the Directorate, coupled with the often cumbersome human resource management rules in the public service, have resulted in long delays in the competition process for staffing positions and in finalizing appointments. Skilled candidates for international tax positions at senior levels are rare, and are in demand in the private sector. Good candidates may lose interest if they have to wait long periods before being offered a position.

24.5 Currently, key positions in the Directorate — including positions of leadership — are filled by using secondments, redeployments and acting assignments. We are concerned that this approach to staffing may result in a lack of continuity and stability and may pose a risk to both the quality of work performed and the Directorate's ability to fully realize potential revenues and protect Canada's tax base.

24.6 Despite having recognized since 1994 the urgent need for a human resource plan, the Directorate is still developing a comprehensive human resource plan and strategies linked to its business plan. During September and October 1998 it initiated a number of actions that, upon completion, it expects will address certain identified problems.

24.7 Existing human resource and performance data bases need to be enhanced and better used to provide managers with information needed for human resource planning.

24.8 If Parliament approves the establishment of the proposed new Canada Customs and Revenue Agency, the Department will become a separate employer and assume most of the responsibility for human resource management. In the absence of a comprehensive human resource plan and strategies linked to the Directorate's business plan, the establishment of the new agency will not in itself resolve the problems outlined in this chapter. It is important that the analysis, planning and implementation of needed human resource initiatives be carried out as soon as possible to ensure that the Directorate can appropriately manage the risks to Canada's tax base that are inherent in international transactions.

Introduction

International tax is a complex and growing field

24.9 Revenue Canada's International Tax Directorate was established in November 1991. It is the focal point for all international tax issues (except legislative issues), with a view to enabling Revenue Canada to respond to them in a consistent and timely way.

24.10 The Department realigned its international tax resources in response to changes in the international environment. Those changes included the removal of trade barriers as a result of international agreements (such as free trade agreements and GATT — General Agreement on Tariffs and Trade); economic union of the European Community and social and political changes in various parts of the world; the growing complexity of international financial transactions; the rising use of tax havens; the increasing number of bilateral income tax treaties and agreements; and the aggressive stance of some of Canada's trading partners.

24.11 The Directorate develops and refines tax administration programs and systems to ensure compliance with the legislation that applies to non-residents and international transactions. It also provides policy guidance and technical assistance on international tax issues.

24.12 For 1996–97 Revenue Canada reported that its international tax programs generated total recoveries of \$630 million.

24.13 The Directorate includes four divisions: International Audit; Non-Resident Assessing and Withholding; Transfer Pricing and Competent Authority; and International Tax Strategy. Exhibit 24.1 shows how the Directorate's staff are deployed throughout Revenue Canada and summarizes the responsibilities of its four divisions.

24.14 The Directorate is responsible for identifying the resources needed to deliver its programs, and for identifying the staff it needs for its functions at Revenue Canada's headquarters. Tax Services Offices (TSOs) are responsible for staffing their own international tax audit positions, using guidelines prepared by the Directorate at headquarters. The Department's human resource personnel at headquarters and at TSOs carry out the identified staffing actions.

24.15 The International Tax Directorate has taken a number of initiatives to manage risk to the tax base. Some of these initiatives are:

- introducing measures to enhance the reporting of world income;
- strengthening, in partnership with the Department of Finance, key legislation in the areas of, for example, transfer pricing, foreign affiliates and disposition of taxable Canadian property;
- addressing the tax implications of electronic commerce in international forums;
- working with Canada's treaty partners to enhance specific compliance activities such as the exchange of information, simultaneous audits, advance pricing agreements, and the examination of tax haven issues.

Focus of the audit

24.16 This audit focussed on human resource management in the International Tax Directorate. Our objective was to determine whether human resource management practices are sufficient to enable the Directorate to manage the inherent risk to Canada's tax base caused by international transactions. Subsequent audits will focus on international tax compliance activities.

24.17 The International Tax Directorate is part of the much larger Verification, Enforcement and Compliance Research Branch in the still larger departmental

Revenue Canada's International Tax Directorate is the focal point for international tax issues.

International tax is a growing field with significant potential for tax revenues.

structure. This has certain implications for human resource management, which we took into account in our audit:

- Most human resource policies are determined by central agencies and implemented by the Department. This affects the Directorate's flexibility to address staffing issues.
- The Branch influences the Directorate's vision and the scope of its activities, along with its resourcing; the assignment of resources depends on the Branch as well as the Department. The level of resources they allocate to the Directorate will reflect the priority they

attach to its activities, as well as the other pressures and challenges being faced by the Department and government.

24.18 Further information on our objectives, scope and criteria can be found at the end of the chapter in the section **About the Audit**.

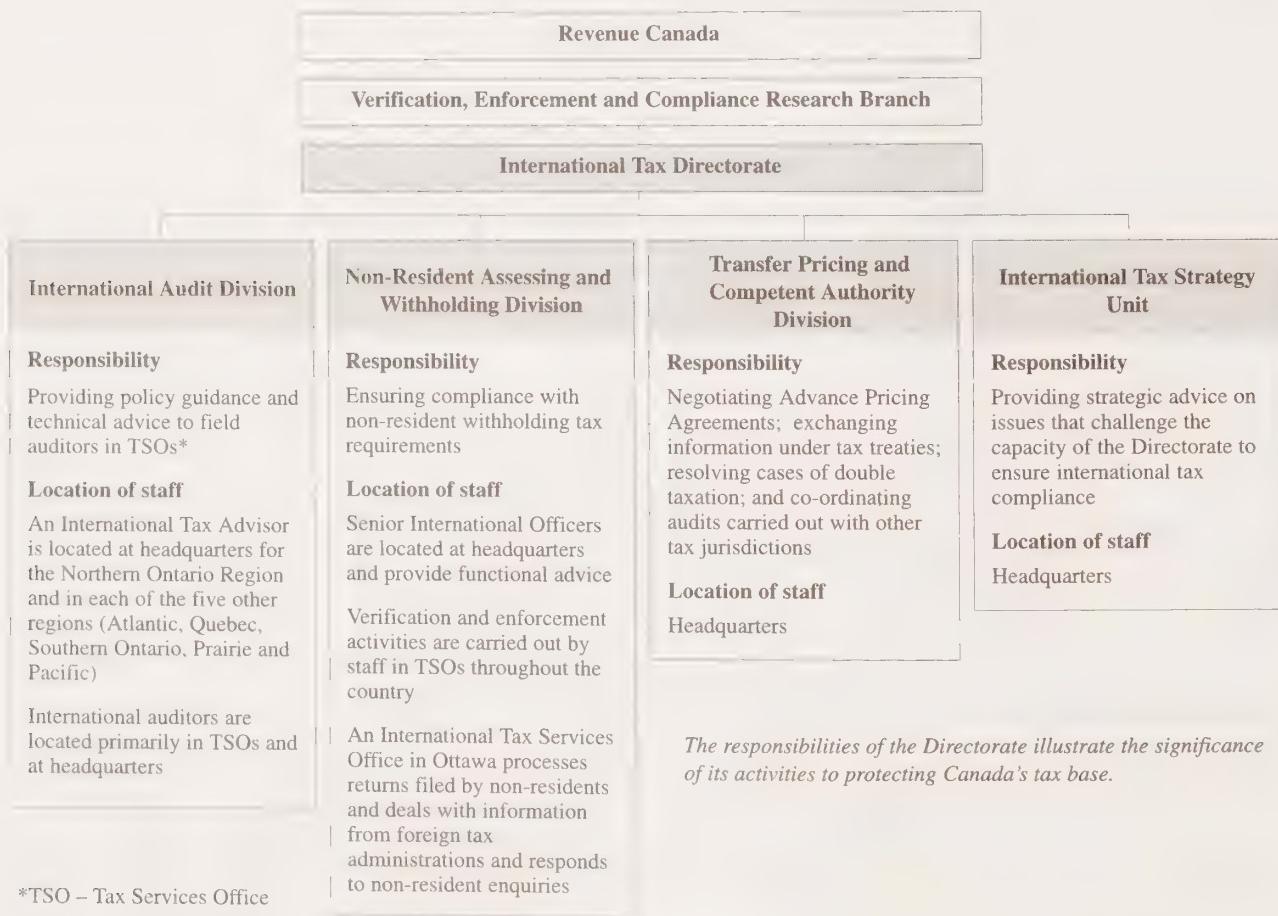
Observations

International Transactions Have the Potential to Erode the Tax Base

24.19 International tax is a growing field with significant potential for tax

Exhibit 24.1

Organization and Responsibilities of the International Tax Directorate



*TSO – Tax Services Office

revenues. In this complicated, knowledge-intensive area, the International Tax Directorate requires a stable work force of highly skilled people. The complexity of its work is reflected in the types of transactions, industries, and policy questions that define its scope — transfer pricing; electronic commerce; non-residents doing business in Canada or disposing of taxable Canadian property; global enterprises and their related-party transactions; tax havens and harmful tax competition; international financing arrangements; and international tax treaties.

24.20 A recent report of the Technical Committee on Business Taxation noted that in 1993, taxpayers reported to Revenue Canada \$248 billion in related-party cross-border transactions, \$166 billion of which were between related parties in Canada and the United States. As the report went on to note, considering that in 1996 Canada raised close to \$20 billion in federal and provincial corporate income tax, even relatively small shifts in income allocated to Canada from related-party transactions have the potential to cause a significant change in the domestic revenue base.

24.21 The report also noted that foreign direct investment into Canada is substantial, in 1995 amounting to

approximately \$170 billion or 20 percent of assets held by Canadian businesses. Outbound foreign direct investment by Canadians is also significant — in 1995 about \$140 billion or 18 percent of total assets held by Canadian businesses — and is rising faster than inbound investment.

24.22 Therefore, the complexity and significance of international tax issues demand that Revenue Canada attract, motivate and retain well-qualified and trained staff who can perform effectively and to a high standard. Its international tax employees must be highly skilled and understand Canadian tax laws and tax laws in other jurisdictions.

24.23 Exhibits 24.2 and 24.3 set out the Directorate's staff resources at the Department's headquarters and at Tax Services Offices across the country.

Key positions have been filled through the use of secondments, redeployments and acting assignments.

Stable Leadership Is Required

24.24 In September 1996, the Director General of the Directorate was transferred to another branch of the Department. A staffing action was undertaken shortly thereafter and the current Director General was appointed in October 1997 — one year later. In the interim, the four Division Directors reported directly to the Assistant Deputy Minister.

24.25 Other key positions have been filled through the use of secondments,

	Permanent in Position	On Loan from Another Directorate	Acting Assignment and on Loan from Another Directorate	Total
Director General's Office	3	4	—	7
International Audit	11	1	8	20
Transfer Pricing and Competent Authority	14	4	6	24
Non-Resident Assessing and Withholding	11	3	10	24
International Tax Strategy	3	—	2	5
Total	42	12	26	80

Exhibit 24.2

Directorate's Staff Resources
at Headquarters, August 1998

Source: Revenue Canada

Only 52 percent of the Directorate staff at Revenue Canada headquarters are in their permanent positions.

Frequent staff movements may prevent the Directorate from maintaining the experience and skill levels the work requires.

redeployments and acting assignments. As of October 1998, three of the four Divisions have as Directors staff who are acting in the positions at a level higher than their own classification level and who are on loan from another work location. The Director of the fourth Division is also on loan from another work location. The acting Directors had advised their staff in February 1997 that they would continue in an interim capacity to allow a new Director General to decide who would hold the positions on a permanent basis.

24.26 We are concerned that in such a situation of uncertainty about whether they will remain in their positions, people may focus on the routine, day-to-day issues and not pay appropriate attention to important long-term planning or make critical decisions about it.

Frequent Staff Movements Are a Cause for Concern

24.27 All functions at headquarters are important in providing overall direction and technical expertise for the Directorate's activities. Therefore, staffing problems at headquarters could have a negative impact on international tax work done in the TSOs.

24.28 Only 52 percent of the Directorate staff at Revenue Canada headquarters are in their permanent

positions, including only 20 of the 32 senior auditors. In the Transfer Pricing and Competent Authority Division, 60 percent of the present staff are in permanent positions. This Division expects to triple its present work force within the next seven months.

24.29 We found that the movement of the Directorate's staff at headquarters was high. At 1 April 1995, there were 58 employees at headquarters, 31 of whom are still there. At various times over the 40 months from April 1995 to September 1998, 66 people left and had to be replaced and 22 more people joined the Directorate's headquarters staff. It currently has 80 employees at headquarters. The Department informed us that 33 percent of the staff who left had been brought in specifically for short-term projects or for developmental assignments.

24.30 In TSOs, 87 percent of the international tax employees are in their positions on a permanent basis. However, only 68 percent of the senior international tax auditors are permanent in the positions. TSO auditors in general have an average of less than three years' experience in international taxation.

24.31 Because of the complexity and the significance of international tax issues, we are concerned that frequent staff movements may prevent the Directorate from maintaining the experience and skill

Exhibit 24.3

Directorate's Staff Resources at Tax Services Offices, August 1998

Region	Permanent in Position	On Loan from Another Directorate	Total
Atlantic	18.5	1.0	19.5
Quebec	59.5	9.0	68.5
Northern Ontario	24.5	—	24.5
Southern Ontario	145.5	12.0	157.5
Prairie	36.5	29.0	65.5
Pacific	60.5	—	60.5
Total	345.0	51.0	396.0

Source: Revenue Canada

Note: Figures do not include staff at the International Tax Services Office.

levels required to provide an appropriate level of service to taxpayers and to manage the risks to the tax base that are inherent in international transactions.

The Directorate Could Take Action to Speed Up the Staffing Process

24.32 Information on recent competitions for positions in the Directorate highlights the time it takes to complete a staffing action:

- A competition for program managers closed in April 1997; in October 1998 the examinations were being marked — 18 months after the competition closed.
- A competition for senior international officer positions closed in August 1997; the results were issued in September 1998.
- A competition for international officer positions closed in October 1997; the examinations were being marked in October 1998, one year later.
- A competition for international tax advisor positions closed in October 1996; the eligibility list was established 18 months later.
- A competition for audit managers closed in May 1997; the examinations were being marked in October 1998, 18 months later.

24.33 The Directorate could speed up the process by deciding, even before competitions are announced, on the selection strategy, process and techniques it will use. It could then develop position-specific selection tools such as interviews and written examinations. It could also screen and respond to applications as they come in, instead of waiting weeks. Skilled candidates for international tax positions at senior levels are rare, and are in demand in the private sector. Good candidates may lose interest if they have to wait long periods of time before being offered positions.

24.34 Statements of qualifications or selection profiles that provide a clearer indication of the experience, skills and traits sought in candidates could be developed to enable potential candidates to better assess their interest and their chances of success.

24.35 The Directorate is developing new job descriptions and classifying positions for some of the new staff it expects to hire over the next seven months. Job competency profiles will not be developed until after the planned 60 percent increase in current Directorate staff at headquarters has taken place.

24.36 We note that in a competition for senior auditor positions that closed in June 1998, the Department screened the applications and administered the written examinations that same month. The examinations were marked in July 1998; candidates were interviewed and the eligibility lists were completed in September 1998. This shows that it is possible to speed up the process.

Better Information Is Needed

24.37 Revenue Canada estimates that the average age of all the auditors in the Branch is 43.7 years. The Directorate will need to have a robust human resource strategy to ensure that as people at senior levels retire, their positions are filled with competent people. In addition, it will require a human resource information system to support its implementation of the strategy.

24.38 The Department has acknowledged that the need for reliable human resource information systems and data bases is a concern affecting all branches. It advised us that it has undertaken a major project to develop a new human resource information system to provide reliable information on key processes such as staffing, classification and performance reviews, as well as other employee information.

Job competency profiles will not be developed until after the planned 60 percent increase in current Directorate staff at headquarters has taken place.

The need for reliable human resource information systems and data bases is a concern affecting all branches.

24.39 The Directorate will need to maintain information on the location, occupational group and level, and years of service of staff who leave or retire. It also needs to keep track of the numbers and levels of staff promoted to positions elsewhere in the Department.

24.40 The Directorate can use the information on staff losses to target retention strategies, recruitment activities, and classification and compensation structures. The monitoring of retention statistics is an essential component of human resource planning.

The Directorate Has Not Developed a Comprehensive Staffing Strategy

24.41 The Directorate has been aware since 1994 of its human resource problems. It has held a number of discussions and prepared and circulated papers that outlined various concerns. For example:

- In 1994, the Directorate recognized in its draft business plan that it would need a human resource plan to identify staffing needs and to recruit, select, train and manage qualified staff.
- A 1996 draft compliance and enforcement strategy for the Directorate indicated the need to address several human resource issues, including developing competency profiles, revising training programs, and developing new courses designed to fill gaps in knowledge and skills.
- In late 1996, the Branch started a project to determine the skills and competencies, career paths and training needs of staff to form an integrated approach to its human resource management.
- In July 1997, the Division Directors in the Directorate prepared a draft paper on staffing issues. It noted that although a

large number of staff have applied for positions as managers and advisors, few had extensive experience in international tax. It also noted that TSO staff with experience in international tax generally did not apply for positions at headquarters. It further acknowledged that successful candidates for vacant positions might still require extensive training and development. The paper stated that because of requirements in domestic tax programs, combined with the fact that the Directorate often performs the role of "finishing school" for the best young talent in the Branch, many of the Directorate's best employees were being promoted to positions elsewhere in the Department. It identified the need for technical expertise at headquarters and TSOs and it recommended the continued use of interim staffing measures including secondments, developmental assignments, acting appointments and temporary assignments.

24.42 We were advised that in April 1998, the Branch created a committee to define the "key principles and parameters" for a comprehensive human resource strategy. On 8 October 1998 we were advised that:

- most, but not all of the key parameters of the strategy had been defined. We asked to see them but, as of 11 October 1998, they had not been provided to us;
- in September 1998, a contract was issued to a professional firm to develop job competency profiles;
- the development of an employee skills inventory system had been put on hold;
- the results of a demographic study of the Branch's work force would be ready in November 1998; and
- the Branch was developing four new audit training and development programs, which would be the "foundation" required to address recruitment issues and to

The development of an employee skills inventory system was put on hold.

proactively manage the longer-term human resource needs.

24.43 While these actions address some of the problems outlined in paragraph 24.41, we are concerned that they are only a piecemeal solution rather than part of a comprehensive human resource plan. This is particularly worrisome because the Directorate is planning to increase its staff at headquarters by 60 percent — from 80 people to 129 people — within the next seven months.

Conclusion and Recommendations

24.44 Our review of the International Tax Directorate's management of human resources identified problems that limit its ability to discharge its responsibilities and to manage the inherent risk to Canada's tax base caused by international transactions. Despite having recognized these problems for a number of years, the Directorate is still developing a comprehensive human resource plan and strategies linked to its business plan for the next few years.

24.45 During September and October 1998, the Directorate initiated a number of actions that it expects will address certain identified problems. However, this is only a piecemeal solution and it does not deal with the underlying problem.

24.46 In our view, failure to take urgent action on these matters will severely limit Revenue Canada's ability to manage the risks to Canada's tax base that international transactions represent.

24.47 If Parliament approves the establishment of the proposed new Canada Customs and Revenue Agency, the Department will become a separate employer and assume most of the responsibility for human resource management currently shared with central agencies. In the absence of a comprehensive human resource plan and

strategies linked to the Directorate's business plan, the establishment of the new agency will not in itself resolve the problems outlined in this chapter. It is important that the analysis, planning and implementation of needed human resource initiatives be carried out as soon as possible to ensure that the Directorate can act appropriately to protect Canada's tax base.

24.48 Revenue Canada should ensure that the International Tax Directorate:

- develops a comprehensive human resource management plan that is linked to its business plan;
- develops and implements a comprehensive staffing strategy to ensure that it has a full complement of staff with the continuity, qualifications, job performance and quality standards that are essential to carrying out its responsibilities; and
- has a human resource information system that provides reliable information on key processes such as staffing, classification and performance.

Department's response:

1. *Development of a comprehensive human resource management plan, linked to its business plan.*

We concur with the importance of linking business planning with human resource planning. With the creation of the Canada Customs and Revenue Agency, the link between human resource plans and business plans will be strengthened and will be a more integral feature of the overall departmental planning process. Please refer to the Department's Action Plan, at the end of the chapter, for additional information.

2. *Development and implementation of a comprehensive staffing strategy to ensure a full staff complement with the necessary continuity, qualifications, job performance and quality standards.*

As noted by the Auditor General, the International Tax Directorate has

Recent actions are only a piecemeal solution and do not deal with the underlying problem.

The establishment of a new agency will not in itself resolve the problems outlined in this chapter.

recognized the need to address the particular human resource challenges that have emerged in the area of international tax and has acted to address a number of these challenges. Key activities to address these challenges are outlined in the Department's Action Plan at the end of the chapter.

In the longer term, as an Agency, the Department will have greater flexibility to tailor human resource strategies to specific business needs. The ability to develop new classification systems and remuneration rates, streamlined staffing processes and the ability to negotiate

collective agreements based on the priorities and needs of the Agency and its unions will create an enhanced capacity to attract and retain key personnel.

3. Development of a human resource information system to provide reliable information on key processes such as staffing, classification and performance.

This important requirement will be addressed by the Corporate Administration System (CAS) project, currently under way in the Department. Please refer to the Department's Action Plan, at the end of the chapter, for additional information.



About the Audit

Objectives

The objective of the audit was to determine whether human resource management practices are sufficient to enable Revenue Canada's International Tax Directorate to manage the risks to Canada's tax base that are inherent in international transactions.

Scope

Our audit scope was restricted to the management of the Directorate's human resources. It was conducted at Revenue Canada headquarters and at various Tax Services Offices. We did not examine the International Tax Services Office.

Criteria

Revenue Canada's International Tax Directorate should have in place appropriate policies, systems, processes and practices to attract and retain sufficient people with the right skills and to provide an enabling environment for them to learn and work.

Approach

We interviewed officials in the Department and experts in the private sector, and reviewed appropriate documents, files and statistics.

Audit Team

Assistant Auditor General: Shahid Minto

Principals: Barry Elkin and Jamie Hood

Director: Marial Stirling

For more information, please contact Barry Elkin.

Revenue Canada provided the following action plan with its response to our recommendations (see paragraph 24.48).

THE DEPARTMENT'S ACTION PLAN

Revenue Canada has an International Tax Program that keeps abreast of change to remain effective and efficient. During the last few years, the International Tax Program has undergone significant restructuring and growth so that it can continue to address the many challenges involved in enhancing Canadian business competitiveness and protecting Canada's tax base.

The Auditor General has examined the human resource management of the International Tax Directorate and made a number of recommendations for addressing the issues he has raised in his report. The Department is taking, or plans to take, the following measures that will respond to the Auditor General's recommendations:

Development of a comprehensive human resource management plan that is linked to its business plan.

As part of its preparation for Agency status, the Department is moving toward an integrated planning process that will more closely link human resource and business planning. It is committed to having a business plan that incorporates a human resource plan. Branch business plans will be submitted in support of this process. The International Tax Directorate will form a component of the Verification, Enforcement and Compliance Research Branch business plan.

The Department will complete a Business Plan, including a Human Resource Management Plan, based on the new integrated departmental planning process by spring 1999.

Development and implementation of a comprehensive staffing strategy to ensure a full staff complement with the necessary continuity, qualifications, job performance and quality standards.

The Verification, Enforcement and Compliance Research Branch has undertaken a number of activities, outlined below, to further improve its capacity to attract and retain competent and professional staff, ensure that staff have the right skills and knowledge to meet future demands, and speed up the staffing process.

- A demographic study is under way.
- The development of competency profiles has begun.
- A Recruitment and Apprenticeship Program has been developed.
- An Accelerated Development Program for officers will be introduced in early fiscal year 1999–2000.
- An Assistant Director Verification and Enforcement and Assistant Director Investigations Trainee Program will be introduced in early fiscal year 1999–2000.
- A Self-directed Career Development Program will be introduced in 2000.
- Pre-qualified pools of candidates for forecast vacancies will be used to reduce the time required for staffing.

To address the significant growth in resources, actions have already been taken to staff vacant and newly created positions. The Directorate expects to complete staffing of these positions in 1999.

Implementation of a human resource information system that provides reliable information on key processes such as staffing, classification and performance.

The Corporate Administration System (CAS), a department-wide project dealing with financial and human resource information needs for Revenue Canada, is in progress. The human resources component will include enhanced human resource information and data bases on key human resource processes such as staffing, classification, performance reviews and employee information. Implementation will begin on 1 April 1999.

The training on the first phase of the corporate administrative systems will commence in February 1999.

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to the House of Commons

Chapter 25
Transport Canada – Investments in Highways

December 1998

Report of the
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Chapter 25
Transport Canada – Investments in Highways

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Chapter 25

Transport Canada

Investments in Highways

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Transport Canada

Investments in Highways

Main Points

25.1 During the last 10 years, Transport Canada has spent about \$1.6 billion on provincial and territorial highways. At the time of our audit, it was involved in 24 multi-year cost-sharing agreements with provinces and territories under the Department's various highway investment programs. Over the last five years, annual total expenditures under these programs have averaged more than \$200 million.

25.2 Each agreement under the highway investment programs is administered by a committee of one federal and one provincial official. Transport Canada has provided little or no support to guide and facilitate the work of the four departmental employees who represent the federal interest on these committees.

25.3 Our analysis of Transport Canada's performance in managing and administering its highway investment programs revealed a number of significant weaknesses. The programs themselves have been managed and administered more like grant programs than the contribution programs they are (the latter require that funding be conditional on performance and on compliance with provisions of an applicable agreement). We noted the lack of a number of sound financial management practices. We also found deficiencies in the information supplied to decision makers in support of proposed new programs. In particular, information on the condition of roads was not properly disclosed; potential environmental impacts of proposed highway programs at the strategic decision-making level were not assessed, as is required; and alternative financing arrangements by provinces were not identified, nor were their implications for traditional cost-sharing arrangements evaluated.

25.4 Further, because its environmental screening and monitoring of projects lacked rigour and were poorly documented, we could not conclude whether Transport Canada had met its statutory environmental responsibilities when assessing (screening) individual projects. Moreover, we found a number of cases in which, contrary to statutory requirements, payments had been made before environmental screenings were completed.

25.5 Despite the hundreds of millions of dollars it has spent on highway investments over the past 10 years, Transport Canada has yet to conduct a program evaluation of its highway investment programs. Accountability reporting to Parliament needs to be strengthened.

25.6 Transport Canada is at a crossroads. There has been some pressure by the provinces for the federal government to renew or confirm its position on highway investments. The Minister of Transport has said that the existing national highway policy needs to be updated. Transport Canada needs to re-examine the National Highway Transportation Policy and make recommendations to the government as appropriate.

Introduction

Transport Canada has invested \$1.6 billion in provincial and territorial highways

25.7 Since the completion of the Trans-Canada Highway, Transport Canada has been the federal government's key arm for investing in provincial and territorial highways. It has done so through a series of ad hoc programs. During the last 10 years alone, it has spent approximately \$1.6 billion on provincial and territorial highways (see Exhibit 25.1). At the time of our audit, Transport Canada was involved in 24 multi-year cost-sharing agreements with provinces and territories, largely under seven separate highway investment programs. Exhibit 25.2 provides information on the programs' objectives. These investment programs are, in effect,

contribution programs: federal funding is conditional on performance and on compliance with provisions of the applicable federal-provincial agreement. (The Appendix to this chapter elaborates on highway investment programs and on the distinction between grants and contributions.)

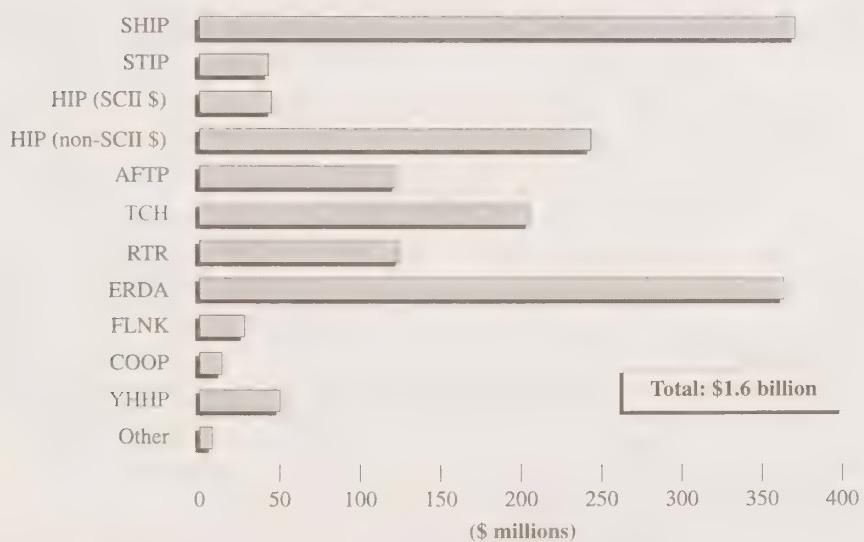
25.8 Federal expenditures under Transport Canada's highway investment programs have averaged more than \$200 million annually over the last five years. Spending is expected to continue at an average of at least \$150 million a year until 2001, and at roughly \$60 million a year thereafter until 2003. It is noteworthy that in 1997–98 the Department's spending on highways represented a sizable portion — roughly 30 percent — of its annual net program and operating expenditures.

25.9 By March 1998, the Department had spent most of the more than \$1 billion

Exhibit 25.1

Transport Canada's Investment per Program, 1987–88 to 1996–97

(unaudited)



Legend:

SHIP	— Strategic Highway Improvement Program	RTR	— Canada-Newfoundland Regional Trunk Roads Agreement
STIP	— Strategic Transportation Improvement Program	ERDA	— Economic Regional Development Agreement
HIP (SCI \$)	— Highway Improvement Program (Strategic Capital Investment Initiative)	FLNK	— Fixed Link Highway Improvement Program
AFTP	— Atlantic Freight Transition Program	COOP	— Canada–Prince Edward Island Co-operation Agreement for Transportation Development
TCH	— Canada–Newfoundland Trans-Canada Highway Agreement	YHHP	— Yellowhead Highway Program

Source: Transport Canada

Exhibit 25.2**Federal-Provincial/Territorial Highway Investment Program Objectives**

Strategic Transportation Improvement Program (STIP)	
Ontario	Enhance efficiency, promote safety, support industrial development, encourage tourism, enhance producer access to markets, improve level of service.
Northwest Territories	Enhance efficiency, promote safety, support industrial development, encourage tourism, enhance Territories producer access to markets, improve level of service.
Strategic Highway Improvement Program (SHIP)	
Yukon	Improve efficiency, improve level of service, support economic development (mining and tourism, in particular), promote safety.
British Columbia	Improve the economy, increase capacity, improve safety, rehabilitation.
Alberta	Increase level of service, reduce travel times, vehicle-operating cost savings, stimulation of the Western economy in areas of tourism, transportation of goods and services and development of natural resources, directly reduce the number of highway accidents and fatalities, reduce the cost of property damage, employment creation.
Saskatchewan	Enhance efficiency, promote safety, support industrial development, encourage tourism, enhance producer access to markets, improve level of service.
Manitoba	Relieve critical bottlenecks, improve safety, support industrial development, enhance producer access to markets, enhance efficiency, encourage tourism.
Quebec	Enhance efficiency and safety, improve competitiveness and economic development, employment creation.
New Brunswick	Increase level of service, reduce travel times, vehicle-operating cost savings, stimulation of the Atlantic Canada economy in areas of tourism, transportation of goods and services and development of natural resources, directly reduce the number of highway accidents and fatalities, reduce the cost of property damage, address current inadequacies of structural components of highway pavements and highway bridges and improved ride quality, employment creation.
Nova Scotia	Increase level of service, reduce travel times, vehicle-operating cost savings, stimulation of the Atlantic Canada economy in areas of tourism, transportation of goods and services and development of natural resources, reduce highway accidents and fatalities, reduce the cost of property damage, employment creation.
Newfoundland	Reduce travel times, vehicle-operating cost savings, stimulation of the Atlantic Canada economy in areas of tourism, transportation of goods and services and development of natural resources, employment creation, reduce the number of highway accidents and fatalities, reduce the cost of property damage, address current inadequacies of structural components of highway pavements and highway bridges and improve ride quality.
Highway Improvement Program (HIP)	
Nova Scotia	Improve efficiency, continued effort to build a high-standard, all-weather highway, provide connections to the major peripheral roads and serving smaller communities and resource areas.
New Brunswick	Improve traffic carrying capacity, highway safety, upgrading key regional highways, address urban congestion and truck routing, enhance tourism, improve movement of raw forest products, address structural components and pavement conditions, as well as ride quality, strength, traffic carrying capacity and highway safety.

Exhibit 25.2 (cont'd)

Atlantic Freight Transition Program (AFTP)

New Brunswick	The objectives for all five of the provinces under AFTP are: enhance efficiency, improve access to markets, improve level of service.
Nova Scotia	
Prince Edward Island	
Newfoundland	
Quebec	

Fixed Link Highway Improvement Program (FLNK)

New Brunswick	Increase highway capacity, enhance highway safety.
Prince Edward Island	Increase highway capacity, enhance highway safety, relocation of facilities.

Canada-Newfoundland Regional Trunk Roads Agreement (RTR)

Newfoundland	Develop a full and effective transportation system, contribute to the financing of the improvement of the Trans-Canada Highway in the Province of Newfoundland.
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Canada-Newfoundland Trans-Canada Highway Agreement (TCH)

Newfoundland	Develop a full and effective transportation system, contribute to the financing of the improvement of the Trans-Canada Highway in the Province of Newfoundland.
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Construction of two Henri Bourassa Viaducts

Montreal	To build viaduct "Albert Hudon" located between Albert Hudon and Pascal Gagnon and to build viaduct "Boulevard Marien" located near boulevard Marien.
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Quebec (Outaouais) Road Agreement

Quebec	Transferring the Quebec (Outaouais) Road Agreement from the National Capital Commission to Transport Canada. To improve the highway system in the Outaouais.
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Source: Federal-Provincial Agreements

of approved funding under programs in effect since the early 1990s. The government recently provided over \$150 million in additional funding under one program for two provinces, extending it for three more years; two other programs will be in effect until 2003.

25.10 Transport Canada and the federal government are at a crossroads. The provinces have been exerting pressure on the federal government to renew or confirm its position on financing provincial/territorial highway projects. Notwithstanding the recent extension of one program, the federal government's ultimate intent in this area remains unclear.

Focus of the audit

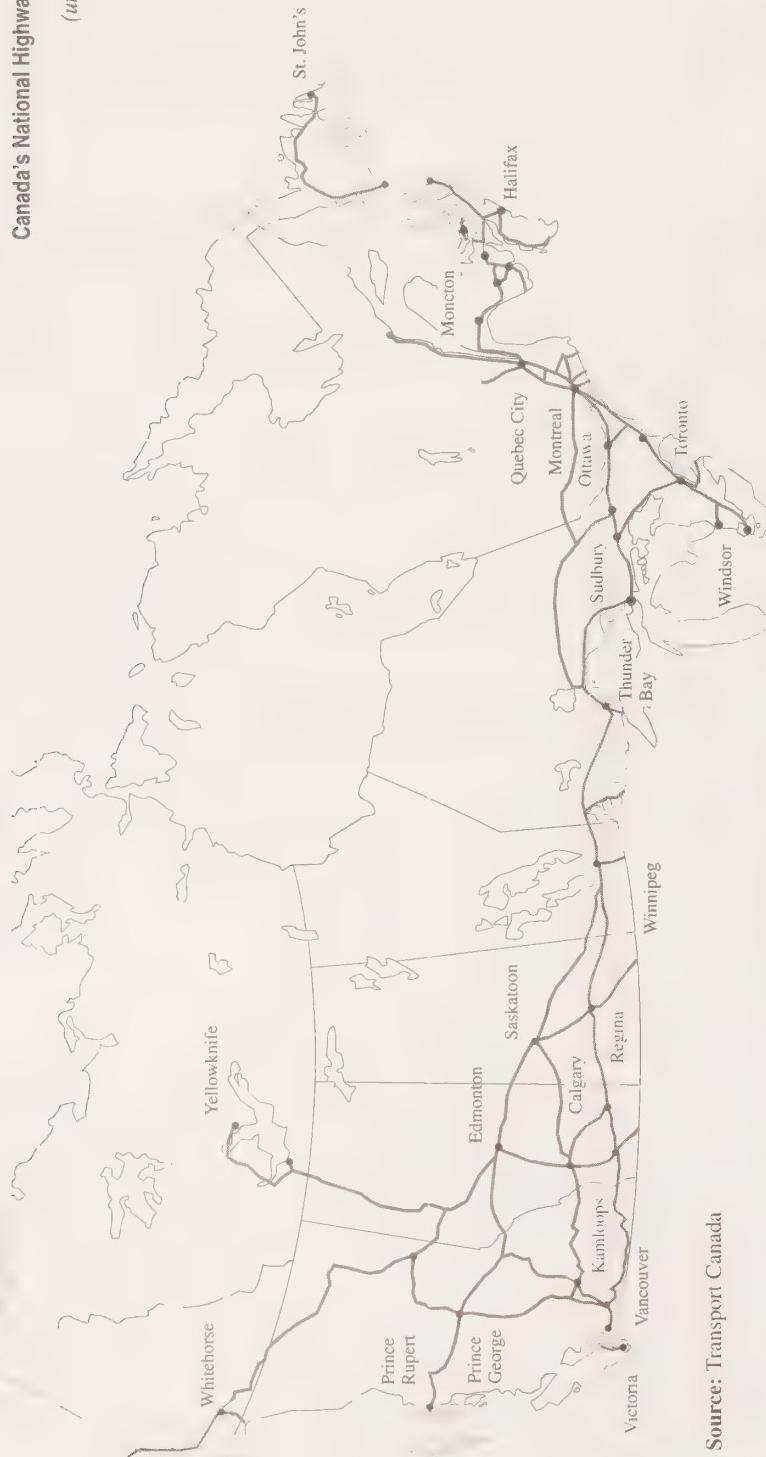
25.11 Overall, our objective for the audit was to determine how well Transport Canada has managed, administered and reported on its highway investment initiatives and programs during the last five years. We also assessed its performance in discharging its other responsibilities related to overall federal spending on highways.

25.12 Our audit concentrated on Transport Canada's highway investments, including a random sample of 96 projects approved from 1992–93 to 1997–98. The projects in our sample represented over 40 percent of the overall value of the projects funded in that period under the

The federal government's ultimate intent for highway investments remains unclear.

Exhibit 25.3

Canada's National Highway System
(unaudited)



Source: Transport Canada

About the National Highway System

The National Highway System is an emerging concept that has not yet been incorporated into any Transport Canada highway policy. A study in the late 1980s, endorsed and approved by the Council of Ministers Responsible for Highway Safety and Transport, defined the National Highway System as the 24,818 km of highways that link capital cities, major population centres, major international crossings and major ports across the country. (In 1996, it reportedly carried over 25 percent of all highway travel.) As part of the study, federal and provincial

transportation officials agreed on the desired design and serviceability features of the System. In 1989, costs of upgrading the existing highways on the National Highway System to meet the proposed service standards were compiled, and were updated in 1998. To date, no agreement has been reached on an arrangement to fund proposed upgrades to the system. The National Highway System Study was not part of the scope of this audit.

Department's highway programs that we reviewed.

25.13 Further details of the audit objectives, scope and criteria are presented at the end of the chapter, in the section entitled **About the Audit**.

Observations and Recommendations

25.14 We have organized our observations under the following three broad categories: establishing highway investment initiatives; managing programs and administering agreements; and reporting to Parliament. The first part of this section looks at federal policy in the area of highway investments and at the information supplied to decision makers by Transport Canada in support of such investments. The second reviews the role of the Department and its representatives in managing programs and administering agreements under them. The third part focusses on accountability reporting to Parliament.

Establishing Highway Investment Initiatives

National Highway Transportation Policy not amended in 25 years

25.15 The federal government has a national policy on highways that dates back to 1974. The policy provides guidance for the establishment and management of highway programs.

25.16 In a recent presentation to the Standing Committee on Transport and the Canadian Council for Public-Private Partnerships, the Minister of Transport acknowledged that a national policy on highways had existed in some form since 1919. However, he questioned the merits of the current ad hoc approach to the federal-provincial highway investments. He favoured a more integrated national highway policy, with clear expectations

and objectives for both federal and provincial governments. The Minister also indicated that the provinces and territories had recently reiterated the need for a comprehensive policy on highways that would include a long-term federal commitment to funding.

25.17 Moreover, since 1974 there have been a number of substantive events in highway transportation that have had implications for decision making about federal highway investments.

25.18 The 1974 highway policy has never been amended to reflect the concept of a national highway system (Exhibit 25.3), defined in 1988 as part of a study. Thus, there is no clear policy on how the concept should guide the management of the Department's highway investment programs. We noted that in some of the programs, projects have to be on the National Highway System to be funded. However, this was not a stipulation in all negotiated agreements we examined.

25.19 The highway policy also fails to reflect many other, more recent events in highway transportation, such as the devolution of federally owned highways to provinces and territories, Transport Canada's objective to eliminate transportation subsidies (as stated in its 1996–97 Report on Plans and Priorities), and the emergence of alternative financing arrangements.

25.20 At the same time, the government has also created new highway investment programs for Transport Canada to administer, and has extended existing ones. In the absence of a clear policy, in our view all of these events, some with apparently conflicting objectives, increase the risk of fragmented, disconnected and inconsistent decision making by the Department. In fact, as we discuss later in the chapter, our observations on the way the Department has managed these programs and administered the agreements indicate a number of weaknesses. The absence of clear policy

Since 1974 a number of events in highway transportation have had implications for decision making about federal highway investments.

The absence of clear policy direction is a matter of concern from the standpoint of effective management of public resources.

direction may be a contributing factor. Given the hundreds of millions of dollars spent by Transport Canada on highways over the past few years and its commitment to hundreds of millions more under programs that remain in effect until 2003, this is clearly a matter of concern from the standpoint of effective management of public resources. Without an up-to-date policy, in our view there is a lack of relevant, adequate guidance for establishing and managing Transport Canada's highway investment programs.

25.21 In light of changing needs and recent developments, Transport Canada should re-examine the 1974 National Highway Transportation Policy and make recommendations to the government as appropriate.

Department's response: The Department recognizes that any federal involvement in future highway programs needs to be pursued within the context of a more up-to-date and strategic transportation policy framework. Transport Canada is currently reviewing this framework. If and when new highway funding programs are deemed necessary by the government, the Department will seek to ensure that these are designed to reflect clear federal transportation policy goals and program objectives. In the interim, action will be initiated to address many of the observations made in this chapter.

Transport Canada not fulfilling its lead role of co-ordination

25.22 In 1998, Transport Canada continues to be one of several federal entities that invest hundreds of millions of dollars in roads. Our analysis suggests that in the last 10 years, the total federal investment in roads and bridges in Canada has amounted to approximately \$3.5 billion. The federal departments with a significant role in managing, operating or subsidizing interprovincial, provincial and municipal roadways have included Public Works and Government Services

Canada, Department of Canadian Heritage (Parks Canada), Agriculture and Agri-Food Canada and Indian and Northern Affairs Canada. The total federal investment in roads and bridges includes the Canada Infrastructure Works Program, which has provided subsidies through various implementing departments for a large number of provincial and municipal works, including roadways (see Exhibit 25.4).

25.23 Despite the number of players and the substantial amount of federal funds invested in highways, activities at the federal level are not co-ordinated in any systematic and formalized way. We note that the 1974 policy directed Transport Canada to play a lead role in co-ordinating information on highway investments at the federal level for the government's consideration, and to chair an interdepartmental committee to facilitate the process. The committee was required to prepare a comprehensive annual report on federal spending, as well as plans for potential future involvement in highway projects.

25.24 Although this direction has never been amended, the Department informed us that the committee remained active only until 1985, and that the comprehensive annual report was last published in 1990–91 due to a lack of resources. Given the sheer size of the federal highway investment, in our view the need for strategic co-ordination remains.

25.25 The government reinforced Transport Canada's lead role. In 1992 the government reiterated the need for integrated information on the condition of federal roads and the level of federal spending when it approved Transport Canada's \$500 million Strategic Capital Investment Initiative (SCII). The initiative provided funding for works on provincial highways as well as on federally owned infrastructure, such as highways in national parks. Transport Canada was directed to report to the Treasury Board

Secretariat annually on the overall status of the initiative. Funds allocated under the SCII for works in national parks were exhausted by spring 1998, as were most of the funds for works on provincial highways. Although the initiative has been in place for five years, Transport Canada has never reported on its overall status and does not have plans to do so. By March 1999, all remaining agreements under the initiative will have expired.

25.26 Since 1993, the Transport Canada initiative has been Parks Canada's major source of funding for capital works on highways in national parks. Our review of the capital component of Parks Canada's business plan for 1996–97 to 2000–01 and our discussions with Parks officials indicate that in the course of its normal multi-year process of dealing with capital works, Parks Canada had made it known that more funding would be needed when SCII money ran out in order to upgrade roads to minimum national and/or provincial engineering standards.

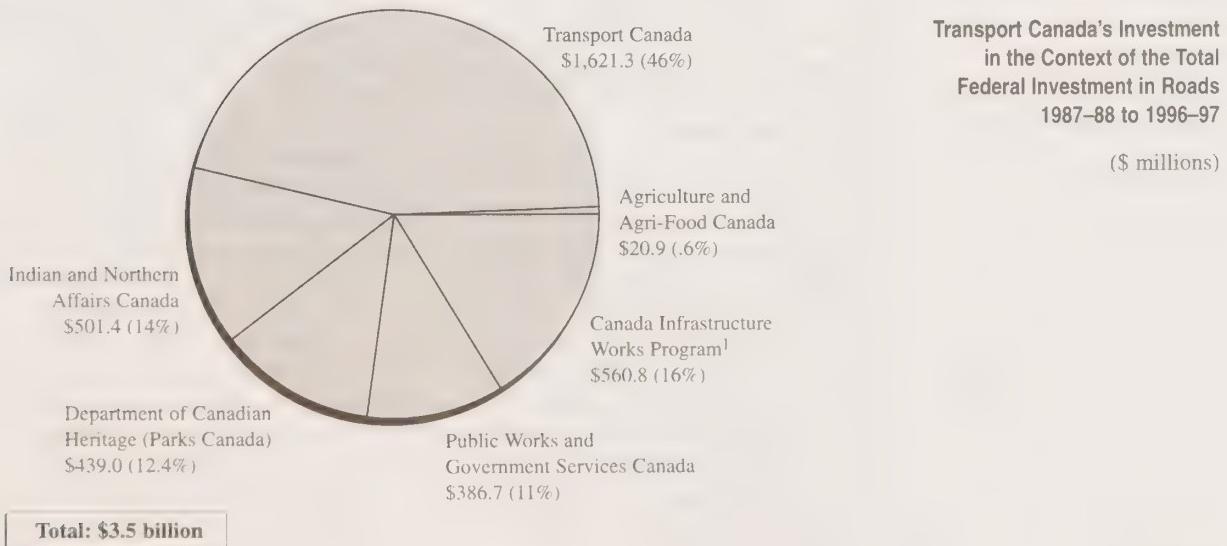
25.27 This is the kind of information that Transport Canada could have been expected to provide in a report on the overall status of the initiative. In our view, the availability of co-ordinated information as envisaged in the 1974 policy would significantly enhance the government's ability to examine various options and to make timely decisions on highway investment, based on a full set of relevant facts.

25.28 We are concerned that the Department has not fulfilled its lead role of co-ordinating and reporting comprehensive information on federal involvement in highways.

25.29 Transport Canada should develop a strategy to enable it to fulfil its lead role, as directed by the government, of co-ordinating information on overall federal involvement in highways. It should also periodically review whether its responsibilities under this role reflect current circumstances, and make

Co-ordinated information would significantly enhance the government's ability to make timely decisions based on a full set of facts.

Exhibit 25.4



¹ \$199.2 million was spent under the Canada Infrastructure Works Program in 1997–98.

Source: Transport Canada

We found that inaccuracies in the information on the condition of roads could leave the impression that the roads were well below minimum national standards, and that billions of dollars would be needed to bring them up to those standards.

recommendations to the government as appropriate.

Department's response: Transport Canada will form and chair an interdepartmental highway committee to co-ordinate information on federal government highway expenditures.

Deficiencies in information supplied to decision makers on investment programs

25.30 We requested the information that Transport Canada had made available to the government for use in its decisions to fund new highway investment programs or to extend existing programs. We reviewed the available information that had been provided in support of the 1992 Strategic Capital Investment Initiative, the various extensions of the Highway Improvement Program from 1993 to 1998, and any other departmental investment program established during that period. For the most part, our review was limited to the Department's submission packages for the government's approval of new program funding.

25.31 During the course of our examination, we reviewed three cases in which we found that some of the information supplied to decision makers had been inaccurate. We also identified other weaknesses, as described in the following observations.

25.32 Information on condition of roads. We identified deficiencies in the information the Department had supplied for the government's use in deciding on the \$200 million in additional funding for the three most recent extensions of the Highway Improvement Program (in 1995, 1997 and 1998). In particular, we found that inaccuracies in the information on the condition of roads could leave the impression that the roads in question were well below minimum national standards, and that billions of dollars would be needed to bring them up to those standards. We note that the cost estimates

supplied by the Department did not represent the cost of bringing the roads to minimum national standards but to proposed design and level-of-service features defined as part of a study on the National Highway System. The Department informed us that in the past, when seeking funding for the National Highway System, it had used the term "minimum national standards" whether it was referring to minimum national standards or to the proposed design and level-of-service features. We are concerned about this, as the cost of upgrading roads to a proposed design and level of service can be substantially and materially different from the cost of ensuring that existing roads meet minimum national standards.

25.33 Moreover, when Transport Canada requested the additional funding in 1997 and 1998, it had conducted a study on the ride quality of the roads on the National Highway System. Although that study had not estimated the cost of upgrading roads to minimum national standards, it had concluded that the pavement surfaces over which much of the traffic moved were acceptably smooth. We further note that according to the same study, the highways proposed for funding were well above the commonly accepted engineering threshold for acceptable surface roughness. Our review of the available documents leads us to conclude that none of this information was disclosed to decision makers when they were considering the two most recent extensions to the Highway Improvement Program.

25.34 We observed other cases in which the Department had supplied inaccurate information on the condition of our nation's highways. In its 1997 Annual Report to Parliament on the State of Transportation in Canada, the Department included the information noted above, with an updated estimated cost (\$17 billion) of upgrading the National Highway System to meet what it

described in that report as “minimum national engineering standards”. It also noted that the overall condition of the National Highway System had not improved in 10 years. As we have mentioned, the \$17 billion was actually the estimated cost of meeting a proposed design and service level. It did not represent the cost of upgrading the condition of existing roads to minimum national engineering standards.

25.35 Information on projects. The information provided to the government in 1995 in support of a proposed \$49 million extension of a highway improvement program indicated that the funding was being sought for additional projects. We found, to the contrary, that some of the funding was for stretches of road for which funds had previously been approved under the same program. We are concerned that without sufficient and relevant knowledge of a project’s particulars and funding history, the government runs the risk of unknowingly approving project funds to meet cost overruns rather than specific program objectives.

Government directives not complied with

25.36 Environmental impacts not considered. Highway investments have implications for the environment: projects can contribute to noise, pollution and global warming, for example. Environmental impact assessments of policy and programs at the strategic decision-making level have been required by Cabinet directive since 1990. In reviewing Transport Canada’s submissions for the funding of proposed programs, we found that it had not conducted any environmental impact assessments of the Strategic Capital Investment Initiative in 1992, or of any other programs since then, and had not indicated this to decision makers.

25.37 Exception noted in negotiated agreements. We also wanted to review Transport Canada’s compliance with government directives on the parameters of the federal-provincial agreements under these programs — namely, program objectives, funding levels and cost-sharing ratios. Along with the Department’s submissions, we reviewed the government’s decisions on them and the agreements subsequently negotiated by Transport Canada with individual provinces or territories. We found in all the negotiated agreements that the program objectives, funding levels and cost-sharing ratios to be maintained throughout the life of the agreements reflected the government’s directives.

25.38 In approving the most recent extension, however, the government added a requirement that all projects be subject to cost/benefit analysis. This requirement was not included in the agreement subsequently negotiated, and the Department did not inform decision makers of that fact. At the conclusion of our audit, none of the projects approved for funding under the latest extension program had been subjected to any cost/benefit analysis.

25.39 Transport Canada should ensure that any information on the condition of roads that it provides to decision makers in support of new program funding has been checked for accuracy and assessed for reasonableness. In the event that no such information is available, it should inform decision makers of that fact.

Department’s response: Transport Canada will continue to provide decision makers with the most current and relevant information available on the condition of highways, as well as on the economic, social and environmental requirements for highway maintenance and upgrading. It will also include a statement about the completeness and quality of information, where applicable.

Without sufficient knowledge of a project’s particulars, the government runs the risk of unknowingly approving project funds to meet cost overruns.

Transport Canada has not conducted any environmental impact assessments at the strategic level for highway investment programs.

Transport Canada has yet to complete any overall analysis of the potential implications of alternative financing arrangements.

25.40 Transport Canada should comply with all government directives, including the requirement to conduct environmental impact assessments of proposed new programs as well as existing programs for which new funding is sought, and should inform decision makers if it is unable to do so.

Department's response: Transport Canada, in conjunction with the Canadian Environmental Assessment Agency, is currently updating its departmental procedures to ensure that Strategic Environmental Assessments (SEA) of departmental policies and programs are conducted. The Department has also committed, in its Sustainable Development Strategy, to fully implement the SEA process for any new program proposal involving direct budgetary transfers.

Poor handling of alternative financing arrangements

25.41 Traditionally, governments in Canada financed the construction and maintenance of highways entirely from tax revenues or the issuance of government bonds. Cost sharing of highway programs between the federal and provincial/territorial governments reflected that reality.

25.42 Since the governments paid all the costs, principles of cost sharing focussed on spending limits and the share of the costs that each was prepared to fund, often matched dollar for dollar. The highways would be freeways, and ownership would stay indefinitely with the provincial/territorial governments.

25.43 But given their budget constraints, since the early 1990s some provinces have been exploring and implementing alternative financing arrangements in an effort to undertake highway construction, improvement and maintenance more quickly and at a lower cost to taxpayers. These arrangements include a wide range of features. They often involve direct user fees or tolls, but

could also entail the transfer of public assets to the private sector. During our audit, we reviewed the three cases that came to our attention in which Transport Canada had invested a total of \$76 million in provincial highways identified either previously or subsequently as subject to some concept of user pay, such as tolls.

25.44 Given the absence until 1998 of any government direction on alternative financing arrangements, we were interested in how Transport Canada had addressed the issue in general and, more specifically, in the three cases at hand. We found its performance lacking in several key respects.

25.45 Failure to analyze and obtain clarification from government. We requested the Department's analysis of the potential impact of alternative financing arrangements on the federal government's traditional position on highway investments. As a minimum, we would have expected timely analysis of their implications for such things as:

- eligibility of projects;
- the principles of traditional cost-sharing arrangements;
- expectations for a refund of federal investments;
- potential transfer of public infrastructure to the private sector; and
- applicability to the National Highway System, which encompasses key routes for interprovincial and international trade.

25.46 Transport Canada has informed us that it has not completed any overall analysis of the potential implications of alternative financing arrangements, even though it approved a project on a highway that as early as 1993 it had known would be tolled.

25.47 The Department did not seek clarification from the government on how to deal with alternative financing arrangements before entering into

federal-provincial agreements under highway programs. The failure of the Department to respond to this emerging issue in a timely manner is particularly worrisome because the government has approved funding under several new highway investment programs since 1992, involving over a billion dollars in federal commitments. We note that none of the agreements predating 1998 addressed the issue of alternative financing arrangements, even in cases where the provision of additional funding had presented opportunities to amend these agreements.

25.48 Poor implementation of Minister's direction. Provinces have also expressed the need for clarification of the treatment of tolls under federal-provincial programs. In late 1994 and early 1995, two provinces requested that the federal government clarify its position on its funding of toll highways in cost-sharing agreements under the Strategic Highway Improvement Program and the Strategic Transportation Improvement Program.

25.49 In both instances, the Minister of Transport responded that he was not opposed to tolls so long as the cost-sharing ratio in negotiated agreements was not modified as a result. Referring to the case under the Strategic Highway Improvement Program, the Minister added that any revenue from tolls would be considered funds from an additional source, to be dedicated to the particular project.

25.50 Also in that case, the Minister directed the departmental official on the management committee to review the alternative financing arrangement between the provincial government and a third party and ensure that it met federal terms and conditions. However, this was not done. The Department told us that the province had not made the agreement available for review by the departmental official before it was signed.

25.51 Although unable to implement the Minister's direction, the departmental representative did not so inform the Minister and signed the contract authorizations allowing the province to claim funding for project costs.

25.52 Consequently, the federal government may not have leverage to ensure that the province invests all proceeds from tolls into the project. We note that subsequent agreements signed by the Department also did not reflect the Minister's direction on the use of toll revenues from highways in which the federal government has an investment.

25.53 In the case of the Strategic Transportation Improvement Program, the province that in 1995 asked for clarification of the treatment of tolls opted not to introduce tolls on the highways in question.

25.54 Change of status following funding. In the third case we examined, we found that at the time the federal investment was approved, the provincial government had not announced specifically that it intended to toll those sections of highway. However, when the province decided to incorporate into a larger toll highway the sections of highway built with federal assistance, it became apparent that the current form of the agreements provided no legal leverage to the federal government over the treatment of its investment throughout the life of the highway.

25.55 Another province has recently announced that it intends to explore the possibility of transferring to the private sector a major toll highway that has received federal funding. It appears that nothing in the current agreements protects the public interest if assets are transferred to the private sector.

25.56 Recent improvements. In the two most recent funding extensions of the Highway Improvement Program, the federal government has precluded the

It appears that nothing in the current agreements protects the public interest if assets are transferred to the private sector.

imposition of tolls for 30 years unless it reaches an agreement with the provincial government on the treatment of the federal contribution. At the conclusion of our audit, one of the two federal-provincial agreements negotiated to cover these extensions reflected this prohibition. The other had not been finalized.

25.57 However, the Department has yet to clarify its position on the treatment of its investments under the Highway Improvement Program or to provide any related guidance to the federal officials on the management committees. While it is encouraging that some action has been taken on this matter, we are concerned that the one finalized agreement may not be workable as currently worded: it does not provide for monitoring over the 30-year prohibition period. Under the agreement, the management committee will continue to be in effect for only 18 months after the program ends. Furthermore, this agreement provides funding to projects previously funded under other agreements that do not contain such a prohibition. Which agreement takes precedence is something that needs clarification.

25.58 We do wish to acknowledge that in 1997, following a recommendation of the Standing Committee on Transport, the Department initiated a study by a federal-provincial/territorial working group on the applicability of public-private partnerships in a Canadian context. Public-private partnerships are a form of alternative financing arrangement that generally involves some concept of user pay. Among other things, the working group has been tasked to gather information on experience worldwide with public-private partnerships. It is to develop a primer and analytic tools for reviewing whether and how public-private partnerships can be implemented in specific situations. At the conclusion of our audit, this study was still under way.

25.59 The government is on the threshold of deciding on new investments; Transport Canada needs to clarify the federal position on alternative financing arrangements. We are concerned that without proper clarification, it will be difficult for the federal officials on management committees to administer appropriately the projects under the various agreements. Moreover, whatever decision is made on the federal treatment of alternative financing arrangements, the Department needs to provide the necessary structures and procedures to enable a proper implementation of the federal position over the long term.

25.60 **Transport Canada should seek clarification of the federal position on the treatment of alternative financing arrangements for its highway investment programs and its application not only to tolls but to such arrangements in general. It should assess the need for entrenching that position in all new federal-provincial highway agreements, and take action as appropriate.**

Department's response: The Federal/Provincial/Territorial Working Group on Public-Private Partnerships, which is chaired by Transport Canada, is completing its final report, along with background studies. The report describes an approach to how federal contributions under cost-shared agreements could be considered in the case of highway projects involving toll revenues. The report also describes possible new instruments, other than cost-shared agreements, of federal-provincial/territorial co-operation in support of the National Highway System. While these approaches have been discussed within the Working Group, further discussion and negotiations with provinces and territories will be required before these can be reflected in future federal-provincial/territorial highway agreements.

25.61 **Transport Canada should provide departmental representatives**

with guidelines for managing projects under federal-provincial agreements that involve alternative financing arrangements. It should back those guidelines with appropriate monitoring practices to verify that they are being followed.

Department's response: Agreements on future projects involving alternative financing arrangements will contain specific clauses addressing how federal expenditures are to be treated under alternative financing arrangements.

Managing Programs and Administering Agreements

25.62 In this section, we review the role of Transport Canada and that of its representatives who act on the federal government's behalf in managing programs and administering agreements. We discuss the accountability relationship between the two, as well as the financial management regime for the government contributions the Department administers in the form of highway investments.

Only a very few people manage and administer highway investment programs

25.63 Each of the 22 federal-provincial agreements we reviewed was administered by a management committee made up of one federal and one provincial official (see Exhibit 25.5). During the last five years, these committees have been required to approve, monitor and report on more than 600 infrastructure projects. The federal officials sitting on the committees were also responsible for approving several hundred construction contracts for the projects. There are four Transport Canada employees representing the federal interest on all 22 management committees. The responsibilities of the federal-provincial management committees are set out in each agreement and are essentially the same for both parties (see Exhibit 25.6).

25.64 In addition to these four federal officials, only five other Transport Canada staff are directly involved in the day-to-day management of the Department's highway investment programs. Outside the function of the management committees, program delivery responsibilities include preparing submissions to the government for

During the last five years, only four Transport Canada employees have represented the federal interest on management committees required to approve, monitor and report on more than 600 infrastructure projects.

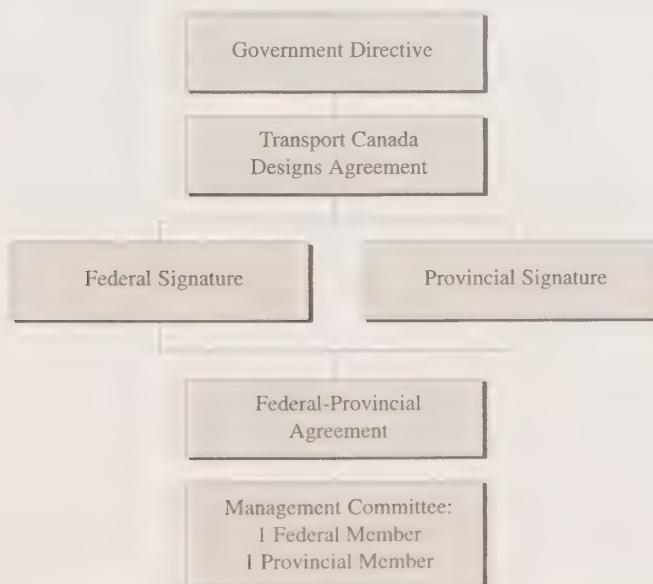


Exhibit 25.5

Accountability Framework

Source: Office of the Auditor General of Canada

The low level of resources allocated to the delivery of highway investment programs is a matter of concern.

approval of new programs and extensions of existing ones; developing and designing federal-provincial agreements; instituting program financial controls; managing the divestitures of federal infrastructure; and reporting on the overall performance of the programs. The Surface Programs and Divestiture Branch is one of three lines of business in the Department that deal with highways, but the other two — Policy and Road Safety — have, at best, very limited involvement in the management of highway investment programs or the administration of the related agreements.

25.65 In view of the responsibilities assigned to Transport Canada and its representatives, the low level of resources the Department allocates to the delivery of highway investment programs is a matter of concern. In 1995, for example, it introduced the Atlantic Freight Transition Program; this added five new federal-provincial agreements for the

Department to manage, including 300 new projects and many more contracts. Yet the level of resources allocated to the administration of highway investment programs remained at relatively the same level. We inquired about the impact of administering this transitional funding on Transport Canada's ability to deliver its various investment programs, but the Department was unable to provide any documentation.

25.66 Transport Canada should study its resource and financial management information requirements to support an effective management regime for its highway investments and institute measures as necessary to fill those requirements.

Department's response: Transport Canada will examine its resources and financial management information requirements and ensure that the

Exhibit 25.6

Roles and Responsibilities of the Management Committee

The Management Committee is responsible as follows:

- The review and approval of all planning activities necessary for the implementation of the agreement.
- The review and approval of all projects necessary for the implementation of the agreement.
- The amendment, modification and substitution of projects from among those listed in Schedule B of the agreement.
- The submission of annual reports to the Ministers on the progress achieved under the agreement.
- Determining the extent to which a contract between the province and third parties may be varied without the approval of the Management Committee.
- Planning, evaluation and communication activities.
- Overview of the preparation and recording by the provinces of the official minutes for all management committee meetings and summaries of decisions. Also the approval and signature of the official minutes.
- Approval of projects to standards agreed to by the management committee (e.g. construction/maintenance and environmental standards).

Also for contract procedures the Management Committee is responsible as follows:

- The approval of contract awarding procedures (all programs).
- The review of tenders and award of contract to the most qualified and responsible tenderer submitting the lowest bid unless it is undesirable to do so (all programs except for Atlantic Freight Transition Program (AFTP)).
- The receipt of each advertisement for tender, together with notice of the time and place for tender opening and participate in the evaluation of tenders (Highway Improvement Program (HIP) and Trans-Canada Highway (TCH)/Regional Trunk Roads (RTR) programs only).

Source: Federal-Provincial Agreements

appropriate measures are in place to meet its obligations.

25.67 We reviewed Transport Canada's performance in providing the necessary operational guidance and technical and administrative support for the management of the programs and for the federal representatives on the management committees. Specifically, we looked at how it selected and monitored projects under the various federal-provincial agreements and how it reported on their results. We selected a random sample of 96 projects, 86 of which were construction works.

25.68 As we indicate in the paragraphs that follow, although a number of financial management controls are embedded in the agreements to safeguard the Crown's interest, we found that the federal representatives on the management committees had not fulfilled their responsibilities to implement them properly. We also found weak performance by Transport Canada in its responsibility to institute the appropriate financial management regime for contribution programs, which highway investment programs represent. Exhibit 25.7 summarizes the major elements of an effective financial management regime.

Improvements needed in design of federal-provincial agreements

25.69 As already noted, one of Transport Canada's key responsibilities is the negotiation and design of federal-provincial agreements that provide a foundation to control the expenditures or funding approved under each program.

25.70 Most federal-provincial agreements on the funding of highway projects are similar in design. Each has three key sections, setting out the amount of money to be expended over a specified number of years and the program's control framework for such things as project and contract approvals, payment verification,

project evaluations and reporting; the program's broad objectives (Exhibit 25.2) as approved by the government; and a list of the projects to be completed under the agreement. The list specifies the locations of the projects, a general description of the work to be done, the estimated total costs and the planned expenditures for the current year.

25.71 A project is defined in the agreements as a set of undertakings, listed in Schedule B of the agreements. We expected to find clear, concise and complete descriptions of those undertakings. Instead, we found that many project descriptions were vague or incomplete. Where projects had received previous funding under different programs this was not indicated and, in one recent case, there was no description at all of the nature and extent of works to be funded.

25.72 We expected that Transport Canada would have done sufficient analysis to support the estimates of project expenditures presented to ministers for approval under the agreements. These expenditures represent the total amount eligible for cost sharing by the federal government and the province to complete

We found weak performance by Transport Canada in its responsibility to institute the appropriate financial management regime for highway investment programs.

Exhibit 25.7

Financial Management Elements

Financial management elements include, among other things, the systems, policies and procedures needed in an organization to provide reasonable assurance that:

- financial risks are appropriately identified and managed;
- relevant, accurate and reliable information is available to decision makers on a timely basis to understand the financial implications of decisions before they are made;
- assets and public money are properly safeguarded and protected against losses;
- money is expended and collected with due regard to economy, efficiency and effectiveness and in accordance with executive financial authorities, laws and principles;
- financial results are reliable, timely and accurately reported;
- financial performance is appropriately monitored; and
- management is held accountable for the results it achieves.

Source: Office of the Auditor General of Canada

a project. They range from a few million dollars to \$80 million for some projects — for example, to “twin” a highway section between two cities. The Department could not provide supporting documentation for the estimates.

25.73 There is thus a risk that additional funding will be needed to complete the projects or that the Department will not be able to fund its share of all the projects approved under the agreements. Further, despite the stipulation in some federal-provincial agreements that any excess project costs (cost overruns) over the total amount approved in an agreement were not to be funded, we found that in some cases the same stretch of highway had been funded sequentially under different programs. We note that the Department did not share this information with the government when seeking approval for the additional funding.

25.74 Because of the condition of departmental records, we could not estimate with any precision the total cost of these stretches of highway. However, millions of dollars were approved for those projects.

25.75 Funding the same projects under different programs is not a new phenomenon. Our review of departmental information found that this situation was known to Transport Canada as far back as 1987.

25.76 Transport Canada should ensure that:

- adequate analysis of the project’s nature and estimated cost is completed prior to seeking approval for a project;
- federal-provincial agreements clearly describe the projects and reflect the true estimated costs of completion, thereby improving the Department’s ability to monitor these projects; and

- any project cost overruns are identified, monitored and reported appropriately to decision makers.

Department’s response: Transport Canada will ensure that future agreements provide greater detail on the specifics of the projects covered under each agreement. More information will be provided on the cost of multi-year projects as well as the portions of the multi-year projects that are cost shared under the agreement.

The Department could not trace payment approvals for a large number of projects in our sample.

Deficiencies in financial management information systems

25.77 Considering that so few people have been allocated to manage and administer such a large number of federal-provincial agreements, projects and contracts, we would expect to find a financial management information system that could compensate.

25.78 However, we found that Transport Canada’s financial management information system has many weaknesses. Not only is it not integrated, but we found that critical documents such as minutes of meetings, project approval analyses, ministerial decisions, monitoring reports, payment decisions, and environmental screening results were dispersed in various places throughout the Department. In many cases, the documents could not be found. The Department’s process to retrieve this information is labour-intensive.

25.79 Management trail is inadequate. As part of our review of the controls embedded in the agreements, we attempted to review the Department’s promptness in making payments to the provinces. We were unable to complete our work because the Department could not trace payment approvals for a large number of projects in our sample. The Department’s financial management information systems were unable to identify the dates when funding was approved and when payments were begun.

25.80 Moreover, basic information — such as the nature and scope of the project and the dates on which construction began and was completed — was not readily available and often was unavailable. In view of the hundreds of projects and contracts being funded, we believe that this type of information needs to be available to facilitate timely monitoring and reporting.

25.81 Transport Canada should ensure that its financial management information systems provide an effective management trail to enable the Department to administer federal-provincial agreements adequately and to demonstrate sound management practices in the process.

Department's response: Transport Canada will undertake measures to change its current information systems with a view to adequately administer federal-provincial agreements and to apply sound management practices in the process. This entails making file information more readily accessible through the subdividing of its Highway Agreement Central Records files, as well as amending its agreements and its computerized Financial Management System to ensure that provinces provide more detailed technical and financial information on the projects.

Transport Canada provides little or no guidance to federal officials on management committees

25.82 As we have noted, the objectives of federal-provincial highway investment programs are stated only in broad terms, like contributing to regional development, safety, efficiency, job creation, rehabilitation, tourism, resource development and so on. Further, federal-provincial agreements call for the Department to implement a number of controls set out in terms that are also broadly stated and not always self-explanatory. These controls include

the approval of provincial bidding processes for individual project contracts under the agreements; the audit of claims and evaluation of projects; and the process for dealing with emerging issues.

25.83 Considering that Transport Canada has overall responsibility for highway investment programs, we asked it to provide us with any specific terms of reference to guide the work of its representatives who serve as the federal officials on the management committees. However, the Department has not developed any criteria to guide their work. Although Transport Canada issued a procedures manual in the late 1980s, it has become outdated and departmental officials no longer use it. Accordingly, decisions in all of these broad areas are left to the judgment of the individual federal official, presenting the risk that projects are not monitored as rigorously and consistently as the Department may believe and that decisions are made without due consideration to the Department's policies and the federal interest.

25.84 Transport Canada should develop up-to-date guidance for the work of the federal officials on the management committees and help to ensure that the federal interest and the Department's policies are considered fully as the committees fulfil their responsibilities.

Department's response: It is Transport Canada's view that existing agreements provide suitable guidance on the roles and responsibilities of the management committee representative. However, the Department is committed to provide greater clarity to the committee in future agreements.

Federal review supporting project approval lacks rigour

25.85 We discussed the basis on which federal officials approve individual project proposals. Our review of 96 projects approved by the management committees

We found that most projects had been approved with little analysis of the extent to which they would support program objectives.

Despite the hundreds of millions of dollars invested in highways, neither Transport Canada nor the federal officials on management committees gather any information on the economic sustainability of the investments.

indicated that some fundamental management practices had not been followed. We found that most projects had been approved with little analysis by the federal official of the extent to which they would support program objectives. We saw no evidence that projects had been subjected to any prioritization based on analysis of needs, assessment of economic sustainability, environment, cost/benefit analysis, safety enhancements or any other criteria before they were approved. Further, in our review of federal files we found no evidence that federal officials had ever denied approval for a project.

25.86 As discussed in paragraph 25.38, the government recently directed Transport Canada to subject all projects under the Highway Improvement Program to cost/benefit analysis. We support this move; we believe that such analysis would be useful in prioritizing projects and maximizing value for scarce investment dollars. We asked the Department to provide us with the results of the cost/benefit analyses for any of the projects recently approved under the Highway Improvement Program. However, at the completion of our audit, no such analysis had been done.

25.87 Despite the hundreds of millions of dollars invested in highways, neither Transport Canada nor the federal officials on management committees gather any information on the economic sustainability of the investments. This information could provide, for example, some details on what it would cost to maintain and replace the completed infrastructure and on the capacity of regional economies to fund such costs in the future, as is required by federal-provincial agreements. This is information that could be used by the management committees to prioritize projects; it could also be submitted for the government's consideration in decisions on funding.

25.88 **Transport Canada should ensure that the approval of projects follows a process of prioritization to identify the most cost-effective choices. The process of prioritizing proposed projects should take into account a number of relevant factors, including but not limited to cost/benefit analysis.**

Department's response: Measures will be taken to ensure that management committee meetings reflect the details of the discussions that evolve around the project selection process.

Lack of information on safety when approving projects

25.89 We reviewed the extent to which Transport Canada has included safety considerations in its investment proposals and decisions. We also looked at the extent to which the federal officials on the management committees take safety into account in the approval and prioritization of projects.

25.90 We found that the Department often had no information on the expected safety impact of proposed projects at the time they were approved.

25.91 Although one objective of each cost-sharing agreement is to improve safety, at the federal level there is a serious lack of related information to guide the federal officials on the management committees.

25.92 We asked the Department and the federal official of each applicable management committee for a report on dangerous segments of federally funded highways. We were informed that this information was not available. We noted that under each of the federal-provincial agreements, there was money available for research to assist in the management of the program. To date, no safety research of national scope has been funded under these programs.

25.93 Currently, Transport Canada has no plan in place to gather information on

numbers of accidents and fatalities by location, which would at least identify the most dangerous sections of Canada's highways.

25.94 Transport Canada collects information from the provinces on road accidents and incidents, but generally uses it to compile statistics on vehicle safety and to summarize key statistics on incidents for its annual reporting. To date, the Department has made no attempt to compile information on "hot spots" or dangerous segments of highways. It believes that in its present form, the information that is available could not be used to identify dangerous stretches of road and it would not be cost-beneficial to do so. However, we have been informed that information on hot spots exists and is used by other levels of government and other federal departments to make road investment decisions.

25.95 We note that a 1993 Transport Canada study identified the need to improve data on the safety of the National Highway System; this would make better information available for decision making. To date, no safety data on the National Highway System have been collected by Transport Canada.

25.96 **Transport Canada should define its data reporting requirements for the collection of information on dangerous stretches of road and, where appropriate, use the collected information in its investment decisions, prioritization and approval of projects and assessments of program results. To the extent that it derives information from the provinces or other sources, the Department should clearly specify to those sources the parameters of its data requirements.**

Department's response: Transport Canada will design data reporting requirements for collecting information on dangerous stretches of roads comprising the National Highway System. The Department will undertake a feasibility

study to validate the data reporting requirements and to develop a costed action plan for data base development, data collection, storage and analysis.

Federal representatives on management committees do not ensure that projects meet any specified standards

25.97 Another key control included in each federal-provincial agreement is the requirement that the management committee agree on the standards to be followed in projects undertaken by the province. The committee is also required to determine the acceptable standard to which funded roads are to be maintained after the completion of projects. We expected that the management committees would agree on such standards and ensure that federal funds would be used to finance only projects that met them. We found, however, that the management committees had yet to agree on standards of construction and maintenance. Currently, neither Transport Canada nor the federal officials on the management committees have collected much evidence to indicate whether funded works have met any acceptable standard.

25.98 We do note, however, that the management committees have obtained some assurance by requiring provinces to submit affidavits by a professional engineer, certifying that the projects have met certain specified standards – usually those of the province. Despite this measure, though, we found that the federal officials on the management committees had not implemented this practice systematically. Affidavits had been received for only 31 of the 86 construction projects we reviewed. In many cases, the province had not provided the affidavit, or had been unable to because funding had run out before the completion of construction. As discussed in paragraph 25.73, these projects are often funded under different programs and agreements, making it difficult to implement this control.

Currently, Transport Canada has no plan in place to gather information on numbers of accidents and fatalities by location, which would at least identify the most dangerous sections of Canada's highways.

25.99 In every case, the federal official on the management committee has yet to agree to the standard to which the province will maintain the federally funded segment of the highway.

25.100 Transport Canada should ensure that the federal officials on the management committees implement all of the controls provided for in the federal-provincial agreements, and agree on minimum standards of construction and maintenance to be met in funded projects.

Department's response: Transport Canada will ensure that the obligations under each agreement are fully met and that identified ambiguous items are corrected.

Federal role in contract review and payment approval is largely passive

25.101 Each contract for each project under the many federal-provincial agreements is to be awarded only after the management committee has approved the competitive bidding process to be used by the province. We found in the projects we reviewed that the federal officials on the management committees had rarely been involved in approving that process.

25.102 In the late 1980s, the Department engaged engineers of the Department of Public Works to perform systematic reviews of the provinces' contracting procedures. This practice was later terminated, but the requirement to approve the competitive bidding process continues to be included in federal-provincial agreements.

25.103 The current process for approving contracts and contract amendments is largely limited to a financial exercise: the figures in Schedule B of the agreement are adjusted to reflect the amount of each contract and amendment, so that funding remains within the total amount approved for the agreement under the program. In our view, the Department's management

and/or administration of contracts does not constitute an appropriate regime for controlling the programs and monitoring projects.

25.104 In addition to reviewing the approval of contract bidding procedures, we also reviewed the Department's process of assessing supporting documentation for provincial claims.

25.105 Federal review of support for provincial claims began only recently. The agreements are designed to allow the management committees to obtain independent assurance annually that the costs claimed by provinces are eligible for payment. Although most agreements stipulate that this work is to be conducted by an independent auditor, they do not define the nature and extent of the audit work.

25.106 We found that in all but two of our 96 sample items, the Department had received an audit opinion from provinces on the eligibility of costs. Each opinion is reviewed by Transport Canada's internal audit group to determine the extent to which it meets the intent of the agreement. In 1997, internal audit concluded that the audit opinions received from the provinces did not disclose the scope of the audit work, the definition of materiality used or the nature of the audit results, and that only a site review could attest to the adequacy of the audit. We were surprised to note that the federal representatives had not been involved in determining the nature and extent of the work to be carried out on their behalf by the provinces' auditors.

25.107 Late in 1996, Transport Canada's internal audit group undertook a review of highway investment programs. Generally, the review was to determine the extent of compliance with the financial requirements stipulated in the agreements and to verify that the claimed expenditures pertained to approved projects. The review was to cover the period from 1993, when most of the programs

In our view, the Department's management and/or administration of contracts does not constitute an appropriate regime for controlling the programs and monitoring projects.

started, to 1998. The Department is currently in the reporting phase of its work; the internal audit group has presented a draft report to program management but the results had not been finalized at the end of our audit.

Management committees fail to meet requirement to report on projects

25.108 According to federal-provincial agreements, management committees are to prepare annual progress reports on projects for the Minister of Transport.

25.109 We found that these performance reports are not always prepared. Further, when the provinces prepare them, the federal officials on the management committees rarely approve them. One of the federal officials told us that this is because resources are insufficient to be able to corroborate the information in the reports prepared by provinces.

Environmental oversight needs to be strengthened

25.110 For any projects funded by the federal government, there is a legal requirement that an environmental assessment (screening or comprehensive study) be completed to determine whether a project is likely to cause significant adverse environmental effects. The funding department must ensure that the screening or comprehensive study is completed and that the report on it includes, among other things, a description of the project and its environment, a summary of potential environmental effects and their significance, comments from the public where appropriate, and a list and description of any mitigation measures needed to reduce significant adverse environmental impacts. We attempted to examine the means by which Transport Canada ensures that projects funded under highway investment programs meet those requirements and any other environmental requirements specified in the

federal-provincial agreements. Our review was limited to 71 projects because the Department was not able to find screening reports on the other 15 construction projects in our sample.

25.111 While the environmental legislation dictates the factors that are to be considered in the environmental assessment of a project, the scope of the assessment is determined by the responsible authority. We expected the Department to have terms of reference for environmental scoping of highway projects, but we found that it did not. Moreover, the completed environmental assessment (screening) reports lacked documentation to demonstrate the nature and extent of consultation with external parties and the basis for Transport Canada's assessment of potential environmental impacts. We are concerned that in the absence of standard terms of reference, adequate documentation and clear project descriptions, environmental assessments (screenings) could be inconsistent. Furthermore, it may not be possible to determine whether they have included all potentially significant environmental effects.

25.112 Transport Canada performs no systematic monitoring or follow-up to ensure that appropriate measures are taken to comply with legislative requirements. Furthermore, the limited monitoring conducted during project construction restricts Transport Canada's ability to ensure that mitigation measures are being implemented. Moreover, without a systematic process of follow-up on environmental matters after construction, Transport Canada is unable to identify any unanticipated environmental damage and to collect the data it needs to ensure that future assessments keep pace with trends in this evolving area.

25.113 In several cases, we found that Transport Canada had not adhered to the requirement to complete environmental screenings before issuing any payments for individual projects. Of the 28 projects

Transport Canada performs no systematic monitoring or follow-up to ensure that appropriate measures are taken to comply with environmental legislative requirements.

In several cases, we found that Transport Canada had not adhered to the requirement to complete environmental screenings before issuing any payments for individual projects.

The Department
informs us that it has
yet to conduct any
formal evaluation of its
highway investment
programs.

for which Transport Canada could locate both the environmental screening report and the first approved claim for payment, we found nine to which payments had been made before completion of the environmental screening.

25.114 Given the lack of proper documentation and reports on environmental screenings, we cannot conclude whether or to what extent Transport Canada has fulfilled its environmental screening responsibilities for the projects we reviewed.

25.115 Our observations on the issue of compliance with legislative requirements are consistent with those reported in Chapter 6 of the 1998 Report of the Commissioner of the Environment and Sustainable Development. That chapter focussed on the *Canadian Environmental Assessment Act*, the role of the Canadian Environmental Assessment Agency and the practices of federal organizations in conducting screenings under the law.

25.116 Transport Canada should demonstrate due diligence in the management of environmental screenings of projects under highway investment programs, backed by an appropriate management information system that would facilitate compliance with environmental laws. Such a system should include a mechanism for monitoring unanticipated environmental effects in order to improve the screening process in future environmental assessments.

Department's response: It is Transport Canada's view that the Department has fully complied with the Canadian Environmental Assessment Act (CEAA) for all projects undertaken in its highway agreements. The Department is committed to developing a centrally located management system that fully documents its compliance with the CEAA.

Reporting to Parliament

25.117 We looked at the extent to which Transport Canada provides Parliament with appropriate accountability information on outputs and outcomes of spending and on departmental performance in administering highway investments.

Program evaluations have yet to be conducted

25.118 Under the federal-provincial agreements, Transport Canada is entitled to conduct evaluations of programs and projects. However, we found that only 6 of the 96 projects we reviewed had been subjected to any form of evaluation. At the program level, the Department informs us that it has yet to conduct any formal evaluation of its highway investment programs.

25.119 Failure to conduct timely evaluations contributes to the lack of information on outcomes achieved with the hundreds of millions of dollars spent each year under highway programs. It also means that the Department has missed opportunities to learn from experience and, where applicable, to use information on results to improve the design of existing highway investment programs or new programs.

25.120 The importance of program evaluation was emphasized in 1994 by the Deputy Minister at the time, who strongly suggested the need to perform such evaluations before committing to further federal investment in highways.

25.121 Further, we were informed that the more recent programs funded through the Strategic Capital Investment Initiative will not be evaluated until two to three years after they end. The Department has yet to develop a framework for evaluation. This means there is a risk that it may lack the data it will need to carry out the evaluation.

25.122 Transport Canada should define the parameters for evaluating the

most recent highway investment initiatives, and establish procedures to ensure that it has the information it will need when it decides to conduct a formal evaluation. It should conduct evaluations on a timely basis, to serve as input into the decision-making process when new investment initiatives are proposed.

Department's response: Transport Canada will prepare an evaluation framework for any new highway program so that its performance can be monitored and data will be available for a future policy evaluation.

Annual report on the state of transportation enhances accountability information to Parliament

25.123 Transport Canada has broadened the information it provides to Parliament on the state of transportation in Canada, in compliance with the reporting requirements of the *Canada Transportation Act*. The report has provided a vehicle for aggregate information on road spending, both capital and operating, by all levels of government, together with some information on the National Highway System, among other things. In the past, the information provided to Parliament on federal spending was limited to that published in the Public Accounts of Canada under each federal department involved in highways. The information was fragmented and not timely. Information available in other public documents through the Main Estimates process was inconsistent, fragmented and often incomplete. To date, two annual reports have been released under the requirement of the *Canada Transportation Act*.

25.124 We are encouraged by the Department's effort to provide aggregate spending information on the state of transportation. With respect to road surface transportation, however, we found

that the quality and reliability of the information could vary significantly depending on its source. In some instances, we found information to be incorrect and incomplete and, in one case, the conclusion to be unsubstantiated (see paragraph 25.34). During our audit we asked the Department for any terms of reference or guidelines that it had in place to ensure that information gathered from various sources, analysis of that information and the resulting observations in the annual report would meet a minimum standard of quality. We found that the Department had no such guidelines. Nor has it attempted to obtain assurance about the reliability of the information it gathers. The annual report does not make this limitation known to the reader.

25.125 We also noted, in the first two annual reports, differences in the kind of information the Department provides on the state of road surface transportation. We observed that the Department has not established a framework for annually reporting the information required under the Act, to permit at least a year-over-year assessment of the state of this mode of transportation. Nor has it defined what other information it still needs to gather to meet all of the Act's reporting requirements. Still, given that the Act is relatively recent, we think the Department has taken some first good steps to tackle these new reporting requirements.

25.126 We also reviewed Transport Canada's 1997 Performance Report for specific information on its performance in administering highway investment programs. However, we found that the information presented was limited to statistics on spending under the programs.

25.127 Transport Canada should establish terms of reference for ensuring that information it incorporates in the Annual Report on the State of Transportation in Canada meets a minimum standard of quality. It should identify the specific year-over-year

Transport Canada has broadened the information it provides to Parliament on the state of transportation in Canada.

information required to permit a proper assessment of the state of transportation. Further, the Department should ensure that it provides Parliament with information on its administrative performance in managing highway investment programs.

Department's response: Transport Canada is continually improving the quality of the Annual Report and an evaluation, which is currently under way, includes a survey of the report's clients. Results will be used to improve the report's usefulness. (Where applicable, the report will clarify that the information being provided is "preliminary" or "estimated".)

Conclusion

25.128 During the last five years alone, Transport Canada has spent over \$1 billion on provincial/territorial highways through a series of ad hoc highway investment programs. At the conclusion of our audit, most of the funding approved under the programs had already been spent. There has been considerable pressure by the provinces for the federal government to renew or confirm its involvement in highway investments. To the extent that Transport Canada provides information in support of

such decision making, it needs to ensure that the information is accurate, considers the potential environmental impacts and also considers the potential implications of alternative financing arrangements for future federal involvement in highways.

25.129 Our audit of the Department's management and administration of programs revealed many weaknesses that, in our view, need attention to ensure that the interests of the public are protected if existing programs continue, and in the event that new programs are established.

25.130 Overall, we found that Transport Canada has managed and administered its highway investment programs more as grant programs than the contribution programs they are. That is, among other things, it has failed to exercise the controls entrenched in the agreements under which these investments were made. We also found that the Department has provided very few resources to manage and administer the programs, and little or no support to guide and facilitate the work.

25.131 Although the Department has improved its accountability reporting on the level of highway spending, we found it has failed to discharge its leadership responsibility to co-ordinate information for the government on federal highway spending overall.



About the Audit

Objectives

Our overall objective was to examine Transport Canada's performance in managing, administering and reporting on its highway investment programs and initiatives during the last five years. We also assessed its performance in discharging its other responsibilities in relation to the federal government's overall spending on highways.

Scope

We focussed on the quality of the information made available by Transport Canada for decision making; its overall management regime for highway investments; the administrative responsibilities of the federal representatives on management committees, including the approval and monitoring of projects under federal-provincial/territorial agreements; the adequacy of environmental screenings; the quality of accountability reporting; and the Department's responsiveness in handling emerging issues — in particular, alternative financing arrangements.

We did not audit the role of the provincial representatives on the federal-provincial management committees; nor did we assess the work of other federal and provincial entities that might be involved in environmental assessments and screening of highway projects. Further, considering that funding and cost-sharing proportions are directed by the government, we excluded those areas from our audit.

Criteria

We expected that:

- government investment decisions on highways would be guided by a clear policy and strategy and that the information presented to decision makers would be accurate, relevant, timely and complete, and would consider environmental implications as and when required;
- agreements entered into with provinces would support an effective and efficient contribution regime, mitigate risks to the Crown, and comply with government directives;
- sound management practices would be followed in the management and administration of federal-provincial/territorial agreements;
- projects would be approved only when they complied with program and departmental objectives and when they followed a process of prioritization to ensure the most cost-effective choices;
- investment programs would be appropriately monitored and evaluated for effectiveness, and the results reported to decision makers;
- government would be kept abreast of new developments and trends in highway financing to ensure that risk management practices for its investments continued to be appropriate and relevant and taxpayers' interests appropriately safeguarded; and
- Parliament would be provided with appropriate accountability information in the form of spending outputs and outcomes and on departmental performance in administering investments in roads.

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Appendix

Federal Highway Investment Programs

Highways are by far the busiest transportation system in Canada

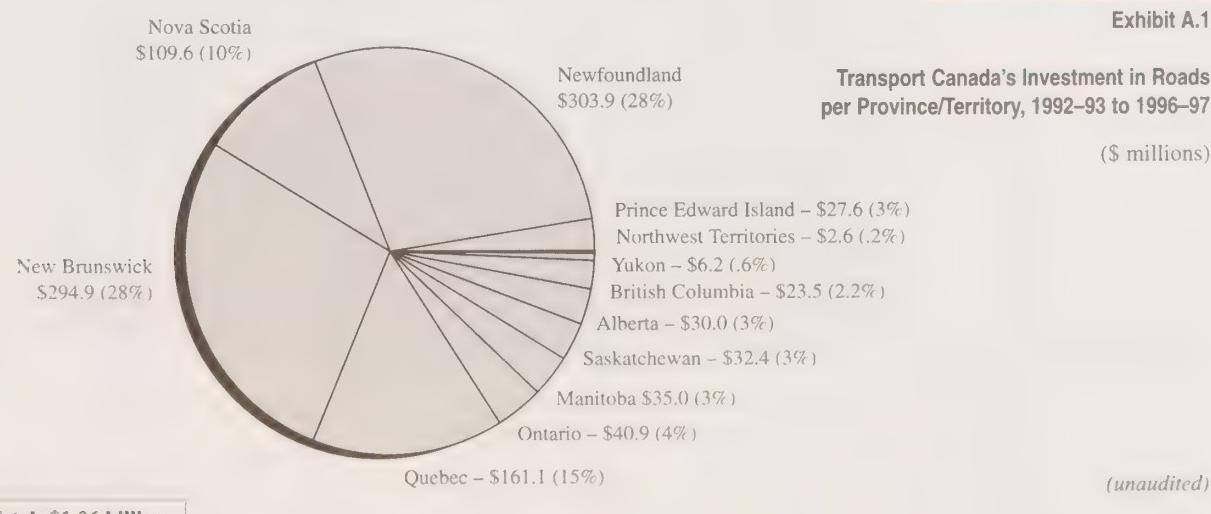
Transport Canada reports that the majority of Canadians use highways to travel between cities. Similarly, most freight travels by road, with truck transport accounting for 72 percent of freight revenue. The vast majority of roads in Canada are owned and maintained by provincial or local governments. Roads under federal jurisdiction represent only a small proportion of the Canadian road network. Nevertheless, since 1919 the federal government has been providing financial contributions to provinces, territories and municipalities to help them in developing their road networks. For example, it contributed hundreds of millions of dollars in the 1950s and 60s to help build the Trans-Canada Highway. Since then, the federal government has contributed hundreds of millions more to help fund provincial and territorial highway construction, largely through bilateral cost-sharing agreements with individual provinces and territories (see Exhibit A.1). Transport Canada has been the key federal department in administering such federal-provincial/territorial agreements. It is one of five federal entities investing in road infrastructure; however, it is the only one involved in bilateral highway investment programs.

Government establishes parameters for highway investment programs

The federal government establishes the broad parameters for highway investment programs, which includes setting funding levels by program and by province or territory. It also specifies program objectives and cost-sharing arrangements, which can vary significantly from program to program. For example, some provinces may share costs equally with the federal government. Others may contribute 30 or 50 percent, or the federal government may provide 100 percent of the funding for a particular program.

As the federal government then directs, Transport Canada is responsible for setting up the highway investment programs and ensuring that negotiated federal-provincial/territorial agreements reflect both the direction and the fundamental principles that the government has approved under each program. Once negotiated, each agreement is administered by a federal-provincial management committee of two: one federal official and one provincial official. Nevertheless, Transport Canada still has overall responsibility for the programs under which these agreements exist.

Exhibit A.1



Generally, these investment programs apply to one or more provinces and territories, and help fund various types of highway construction projects such as paving, resurfacing, adding additional lanes to existing highways and constructing new highways.

The objectives of all the programs are stated in similar broad terms — to support regional economic development, to improve highway safety and efficiency and, in a few cases, to create jobs. However, the federal government's reasons for creating each of the programs have varied considerably. They range from fulfilling constitutional obligations to eliminating ferry and transportation subsidies and other statutory programs, to stimulating Canada's economy by improving provincial and territorial highways. In the 1990s these programs involved extensions of the New Brunswick and Nova Scotia Highway Improvement Programs, first established in the 1980s; the 1990 Newfoundland Transportation Initiatives, earmarked for capital works projects on the province's Regional Trunk Roads and the Trans-Canada Highway; the Strategic Highway Improvement Program and the Strategic Transportation Improvement Program under the 1992 Strategic Capital Investment Initiative, which provided all provinces and territories with funding; the 1995 Atlantic Freight Transition Program, extending to the Maritime provinces as well as the province of Quebec; and the 1996 Fixed Link Highway Improvement Agreements with Prince Edward Island and New Brunswick (see Exhibit A.2).

Although Transport Canada's investments have gone principally to help fund provincial and territorial highways, under one of the investment initiatives the government has provided some funding for works to be undertaken on federally owned infrastructure, such as highways in national parks.

Transport Canada investments do not give the federal government a proprietary interest in the infrastructure or segments of highways funded under any of the programs. Rather, the term "investment" is meant to reflect the broad benefits and savings to Canada flowing from the objectives the programs are intended to achieve. The investment programs are, in effect, contribution programs: federal funding is conditional on performance and on compliance with provisions of the applicable federal-provincial agreement (see Exhibit A.3).

Exhibit A.3

Grants and Contributions: A Comparison

Grants and contributions are part of the category of expenditures known as transfer payments. Transfer payments are transfers of money from the federal government to individuals and to organizations of various types, including businesses or other governments.

Grants

Grants are unconditional transfer payments for which eligibility and entitlement may be verified. This means that if an individual or organization is eligible for a grant, the appropriate payment can be made without the recipient having to meet any future conditions. There is generally less accountability for grants.

Contributions

In contrast, the payment of a contribution is subject to performance conditions that are specified in a contribution agreement. The recipient must continue to show that these conditions are being met in order to be reimbursed for specific costs over the life of the agreement. The government can also audit the use of contributions, whereas this is usually not a requirement for a grant.

Source: Office of the Auditor General

Exhibit A.2

Federal-Provincial/Territorial Highway Agreements: Time Frames

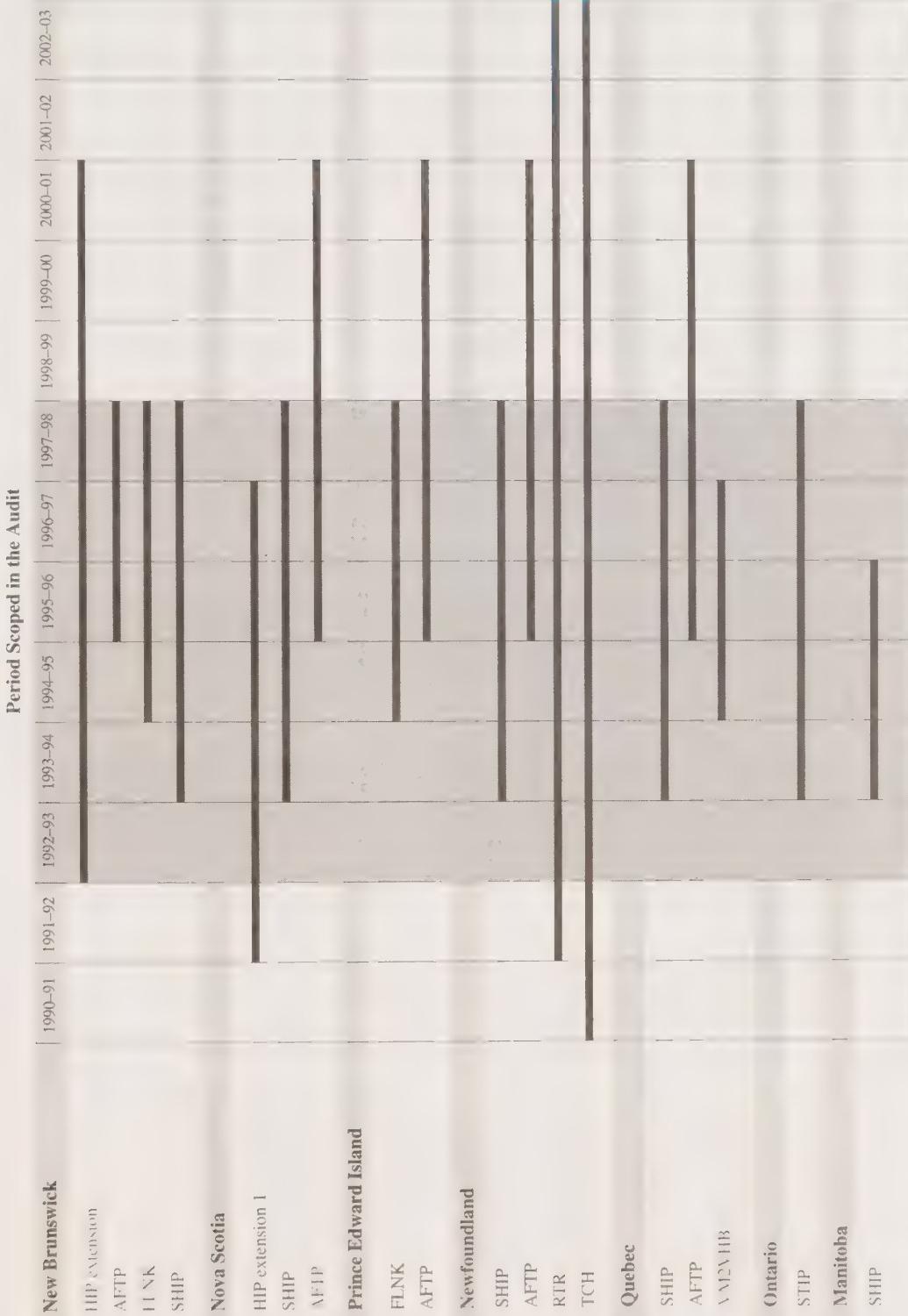
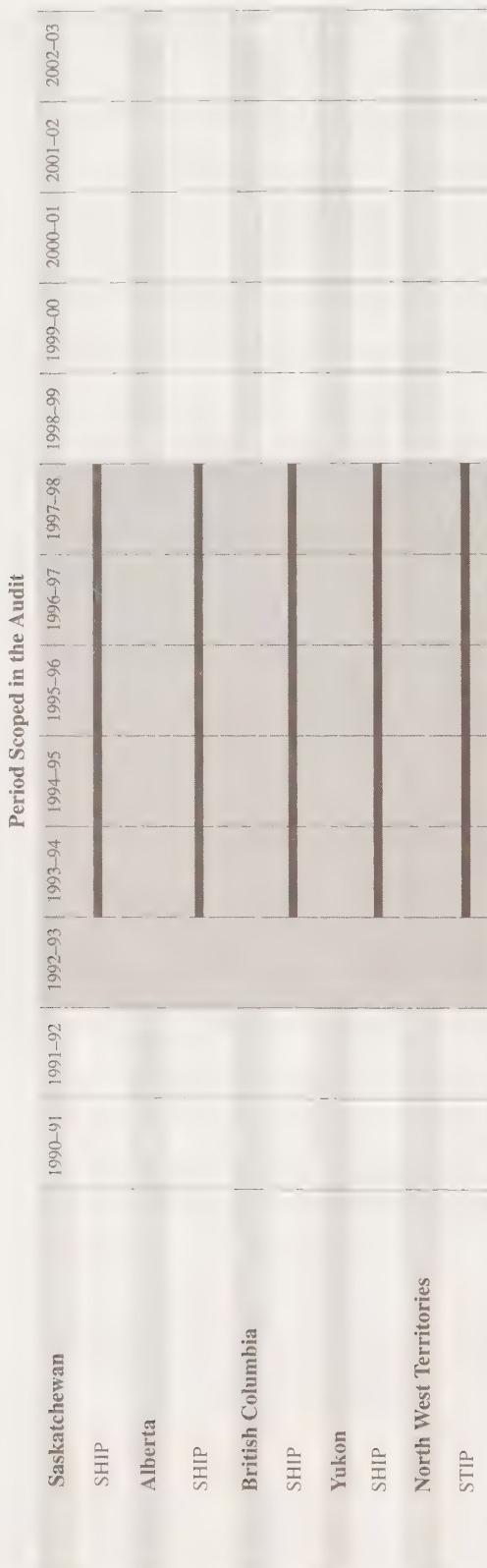


Exhibit A.2 (cont'd)



Note: Transport Canada also administers the Quebec (Outaouais) Road Agreement (QORA)

Legend:

HIP	-	Highway Improvement Program	SHIP	-	Strategic Highway Improvement Program	VM2VHB	-	Construction of Two Henri-Bourassa Viaducts
AFTP	-	Atlantic Freight Transition Program	RTR	-	Canada-Newfoundland Regional Trunk Roads Agreement	STIP	-	Strategic Transportation Improvement Program
FLNK	-	Fixed Link Highway Improvement Program	TCH	-	Canada-Newfoundland Trans-Canada Highway Agreement			Source: Federal-Provincial Programs Agreements

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Report of the
**Auditor General
of Canada**
to the House of Commons

Chapter 26
Contracting for Professional Services:
Selected Sole-Source Contracts

December 1998

Report of the
Auditor General
of Canada
to the House of Commons

Chapter 26
Contracting for Professional Services:
Selected Sole-Source Contracts

December 1998

This December 1998 Report comprises 11 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, September and December 1998 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

Chapter 26

**Contracting for
Professional Services**

Selected Sole-Source Contracts

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Contracting for Professional Services

Selected Sole-Source Contracts

Main Points

26.1 To ensure that the principles of best value and open access are followed in contracting for goods and services, the government's contracting regulations require that contracts valued at more than \$25,000 be let, except in very limited circumstances, through a competitive, open tendering process. Recent work by our Office as well as a report by the Standing Committee on Government Operations show that departments use sole-source contracts extensively. This is a matter of considerable concern because sole-sourcing works against the principle of open access and puts the achievement of best value at risk. The total value of sole-source service contracts awarded in 1995 was about \$1.4 billion.

26.2 We audited a sample from five departments of 26 sole-source contracts for professional services. We selected this type of contract because previous work had led us to believe that it was a high-risk area. Most of the contracts in our sample would not, in our view, stand the test of public scrutiny. Nor do they reflect open access to contracting opportunities with the federal government. The total initial value of these contracts was \$16 million.

26.3 In our sample of contracts we found many instances in which needs analyses, definition of requirements and procurement planning had been inadequate. Departments often underestimate the nature and scope of the work required, and do not always clearly specify what contractors are to deliver. We could find little evidence of contract management: it often appears that the contractors determine what is required, how much effort it will take and at what point the job will be considered completed.

26.4 The justifications for over two thirds of the sole-source contracts we audited did not conform to the exceptions allowed by the Government Contracts Regulations and as defined in the Treasury Board Secretariat's Contracting Policy. This practice results in too many "one-horse races".

26.5 Departments issue many oral contracts that remain unsigned for long periods of time. Treasury Board states that the terms and conditions of any contract issued should be in writing and should be signed as soon as possible after the contract is awarded.

26.6 In several cases departments were not able to demonstrate that their managers had, as required by the Treasury Board Secretariat's Contracting Policy, documented and assessed the extent to which contractors had fulfilled the contract terms. In the absence of appropriate certification and documentation of what the contractors delivered, neither we nor management can be assured that due regard to economy was shown in the letting of those contracts.

26.7 In most of the contracts we examined, government regulations were not followed. Clearly, we are concerned about this. In 1997, we examined the contracting process and concluded that the current regime that governs contracting was itself sound. Similarly, the Standing Committee on Government Operations examined the contracting process and concluded that the rules were sound. The problem we found is that departments disregard the rules that apply to sole-sourcing. Moreover, disregarding them appears to involve no significant consequences for either the managers responsible or their departments. (This was the first in a series of contracting compliance audits planned by the Office.)

Introduction

26.8 Two complementary principles are central to government contracting: best value and open access to contracting opportunities. The principle of best value is to ensure that in acquiring goods or services for the Crown, the government receives the best combination of value and price. The principle of open access gives all qualified vendors a fair chance to do business with the Crown without political or bureaucratic favour. An open, competitive bidding process provides the best guarantee that both of these principles will be respected.

26.9 In certain limited circumstances, however, it may be impractical or undesirable to hold an open competition and a directed or sole-source contract must be let. The Government Contracts Regulations recognize and provide for this when the value of the contract is relatively small, there is an urgent need for the good or service, it is not in the national interest to have an open competition, or the good or service is unique and can be obtained from only one source.

26.10 In 1994 the House of Commons Standing Committee on Government Operations, concerned about the level of non-competitive or sole-source contracting, began an investigation that was to last for more than two years. During its hearings, the Committee heard extensive testimony on contracting with the government — and on the rules that governed the process — from the private sector, operating departments, Public Works and Government Services Canada (PWGSC) and Treasury Board Secretariat. In its report issued in April 1997, the Committee concluded that while there had been some improvement in government contracting, much remained to be done. (See Appendix A for the Committee's Report.)

26.11 The Committee also reaffirmed that the principles of best value and open

access were central to the government contracting process. Its recommendations were focussed on ensuring that greater respect would be paid to these principles in the future.

26.12 Normally, the government responds formally to reports of standing committees within a specified period of time. However, we were informed that in this case the government will not be responding to this Committee's report because the dissolution of Parliament for the 1997 election meant that the report died on the order paper. The government has stated that the recommendations of the Committee were reviewed internally and influenced later policy revisions.

Extent of the government's contracting for services is significant

26.13 One of the concerns of the Government Operations Committee was the need for current and credible information on government contracting activity. We found that the most recent information available at the time of our audit was the Treasury Board Secretariat's Annual Contracting Activity Report for the calendar year 1995. Although this information is dated, it does offer a general sense of the extent to which the government contracts for services.

26.14 In 1995 the government's total spending on service contracts amounted to about \$4.4 billion. Of this amount, \$649 million (or about 15 percent) represented contracts for less than \$25,000. As of October 1996, the regulations permit contracts for \$25,000 or less to be let without competition (previously the limit was \$30,000). This recognizes the fact that although competition for small contracts is encouraged, it is not always cost-effective for the government or industry. The rest of the service contracts — amounting to some \$3.7 billion — were for initial amounts greater than \$25,000 and hence, except for those that met the criteria for exemption, would have been expected to

The principles of best value and open access are central to the government contracting process.

be let on a competitive basis. However, the data show that competitive bids were sought for only 51 percent of those contracts.

26.15 In the last few years there have been significant developments that have affected contracting activity. These include:

- increased delegation of authority to individual departments for contracting of services;
- the option to use service providers other than PWGSC (the government's common service provider);
- higher dollar levels delegated to departments for use of MERX, the current electronic bidding system that is replacing the older Open Bidding Service;
- increased use of the MERX/Open Bidding Service, including Advance Contract Award Notices; and
- increasing numbers of contracts for services and at higher dollar values.

26.16 As a result of these developments, departments can be expected to engage more often in direct contracting for services without the assistance of PWGSC in its role as the independent common service provider. Because service contracts are generally let directly by departments, we did not include PWGSC in the scope of this audit.

Focus of the audit

26.17 Chapter 6 of our 1997 Report presented the results of our audit of contracting performance. The chapter set out the general roles, responsibilities and expectations in the government's use of contracting for goods and services. A major contribution of the audit was the development of performance criteria and indicators for contracting, as well as a broad framework for conducting future audits of contracting. (See **About the Audit** at the end of this chapter and

Appendix B for a discussion of the audit criteria, which we also used in the present audit.) In addition, in our 1997 Report Chapter 19 on the commercialization of the air navigation system we raised concerns about the handling of some specific contracts.

26.18 In light of our earlier findings and the Government Operations Committee's report recommendation that we audit sole-source contracts, we decided to begin a series of audits of contracting that would focus on testing specific transactions for compliance both with the criteria we had established and with government policy and regulations. This audit was the first in that series. A review of a variety of sources indicated that sole-source contracts for professional services represented a particularly high risk and, accordingly, they became the focus of this audit.

26.19 We examined a sample of 26 sole-source contracts in five departments to determine, among other things, whether in letting these contracts the government had adhered to the governing principles and regulations.

26.20 We had hoped to be able to take a statistical sample of sole-source contracts for professional services. However, we found that the nature of the information maintained in central agencies and most departments made this impractical. We decided to select about five contracts let in 1996 from each of five major departments — Correctional Service Canada, Fisheries and Oceans, Health Canada, National Defence, and Transport Canada. Because ours was a selected sample, the results cannot be generalized statistically to the broader population of similar contracts. However, the cases were not chosen in any targeted or biased way that would have led to the sample being unrepresentative of the practices used in sole-sourcing contracts of the type we audited. A discussion of some of the cases is presented on pages 26–10 to 26–12.

We examined 26 sole-source contracts in five departments.

26.21 We focussed only on the actions of government officials as they entered into and administered these contracts. We did not audit the contractors, and we make no comment on their actions.

Observations

26.22 The results of our audit of the contracts in our sample are summarized against our criteria in exhibits throughout this section. The exhibits indicate the number of contracts in the sample that either met or failed to meet the particular criterion. Our audit results are presented by stage of the contracting process. First we look at contract screening, the stage that involves deciding whether and for what to contract. Next we look at the decision to use a sole source and the justification for that decision. Then we look at the process that management used in its discussions with contractors to provide price and value protection for the Crown. Next, we look at the controls exercised upon receipt of the deliverables under the contract and controls over the payment process to ensure that work was done according to the contract and that full value was received before the contractor was paid. Finally, we look at contracts that were amended and assess the controls on the use of amendments.

Weaknesses in Documentation and Monitoring

No file contained all of the required documentation

26.23 The Treasury Board Secretariat's Contracting Policy states:

...contract files should be established which will provide a complete audit trail containing details on matters such as options, decisions, approvals, amendments, if any, etc., and identifying the officials or authorities who made them. This is extremely

important for answering questions and evaluating results.

26.24 We expected, when we began the audit, that most of the documentation we would need for our audit work would be readily available in the contract files. However, we did not find any files that in our view met all of the Treasury Board Secretariat's requirements. Further, in many instances, departments were unable to provide even key documentation and, because of staff turnover, the people who might have explained the gaps were no longer available. Accordingly, a "not met" indication in the exhibit tables means that either the file was complete but the quality of the documentation was below standard, or the file was incomplete and the department was unable to supply the missing documentation. In either instance, a "not met" indicates that we, as Parliament's auditors, are unable to provide assurance that managers have shown due regard to economy and respected the principles of open access and best value.

In many instances, departments were unable to provide even key documentation.

Monitoring of compliance with contracting policies is poor

26.25 The section on monitoring in the Treasury Board Secretariat's Contracting Policy discusses the reporting mechanisms and performance indicators that are used for contracting:

Two mechanisms will be used: departmental audits and an annual report on contracting. Departments will be evaluated on their compliance with contracting policies and the level of competitive contracting. All departments and agencies awarding contracts and/or amendments, are required to submit an annual report to the Treasury Board Secretariat on all contracting activities....The Treasury Board Secretariat also conducts periodic reviews of contracts for the services of individuals, including those for less than \$5,000.

(continued on page 26-12)



Correctional Service Canada

Unjustified sole sourcing based on a presumption of uniqueness

In this case, Correctional Service Canada justified a sole-source contract based on its presumption that the selected contractor was the only one capable of satisfactorily delivering the service.

The Service wished to adopt a new information technology system for linking its various computers. To do this the Service decided to award a contract for \$200,000 to a contractor. The justification was that since the contractor owned the software to be used, it was best placed to provide the lowest-risk transition for the Service. However, we note that management took no steps to test this presumption.

No bids or expressions of interest were requested from other potential suppliers. An Advance Contract Award Notice was posted. However, in the absence of sufficient detail about the work to be done, other potential vendors would have been unable to determine whether or not they would be interested in bidding.

Given the nature of the services being offered and the wide experience with the software in the industry, it is reasonable to expect that had bids been solicited, other suppliers would have come forward. The Service could then have selected the supplier that represented best value. It could have included in its selection criteria one that looked at how well the bidders had identified and mitigated the project's risks.

Creation of a sole source

In this case, Correctional Service Canada improperly created a situation in which sole sourcing was thought to be necessary. Necessary steps to ensure best value were not taken.

The Service required a contractor to install voice interception equipment. The right to do so is closely controlled, and the contractor would have to be licensed by the Solicitor General of Canada to do the work. The Service sought out the potential contractor and supported the contractor's application for the required licence (renewable annually), which was then issued by the Solicitor General. Then, as only that contractor had the required licence, it was the only company able to do the work and a sole-source contract was awarded on that basis.

During the last five years, the contractor has received a number of sole-source contracts for this type of work. Future contracts are likely, given that the Service plans to install more modern surveillance equipment in many of its facilities over the next few years. The contracts for future work are estimated by the Service to have a value of up to \$600,000.

We have a number of concerns about this arrangement. First, the Service did not proceed in the prescribed order. It should initially have solicited bids from potential suppliers and included in the qualifications the requirement that the selected supplier meet the conditions established by the Solicitor General for receiving the necessary licence. Second, the practice of repeatedly contracting with the same firm is contrary to the intent of government contracting policy. Third, we found no evidence of price support — that the fees the government paid were "market rate". Finally, the "sole-source" justification failed to acknowledge that someone else had done the installation work before the company was formed, and that eventually the client might have to find a replacement if and when the contractor stopped operating.



Fisheries and Oceans

Excessive amendments

This case illustrates the problems that can arise when entering into a contract without a clear understanding of the scope of the work to be done and the amount of work required to do it. The Department arbitrarily estimated that a contract to provide financial analysis services would not exceed \$25,000 and, on that basis, let it without requesting bids. Ultimately, however, the contract was amended to an amount 12 times the original amount.

The Department asked a contractor to carry out a financial review of internal costs. The Department estimated that the task would take

approximately three months. The firm chosen to do the review had extensive relevant experience in work done for other federal and provincial government departments.

Departmental officials told us that they did not have any in-house expertise to determine whether \$25,000 would be adequate to carry out the work as proposed. They did not seek advice on the scope of the proposed work or ascertain whether other firms would be prepared to submit bids. The Treasury Board Secretariat's Contracting Policy states that where the estimated expenditure does not exceed \$25,000, departments may set aside the competitive process. However, contracting

authorities are expected to call for bids whenever it is cost-effective to do so. In circumstances where management is uncertain as to the level of effort needed to carry out the task, seeking bids based on a well defined statement of work would help to ensure that the Department knew the approximate cost of the work before entering into the contract.

After work began, it became apparent that more time would be needed to complete the project. Accordingly, the terms of the original contract were amended to extend the time to approximately 12 months and increase the value to \$300,000.



Health Canada

Use of prior experience to justify sole-sourcing

In this case, prior experience with related work was used as the justification for sole-sourcing.

In April 1996, Health Canada identified a need for a contractor to carry out work on an information technology project. It decided to use a contractor who had been doing work for the Department since 1995 and who was available for further work. It was decided that

because the time frame was short and the contractor was already familiar with the project, the contract, initially for \$50,000, would be sole-sourced. No Advance Contract Award Notice was posted. The contract was later amended to \$90,125 and the delivery date was extended by three months. Subsequently the amendment was cancelled and a number of small sole-source contracts, related to the project and using the same contractor, were let.

This justification does not meet the standard required by Section 6(d) of the Government Contracts Regulations, which requires that the supplier be proved unique before this exemption is invoked. Management took no steps to ensure that no others could have done the work in accordance with its needs. Indeed, nothing on the contract file suggests that the selected contractor was unique, only that the contract was expedient.



National Defence

Unjustified decision that the supplier was unique

This case illustrates the unjustified use of a sole-source contract, based on the unsupported belief that only one source existed. (As noted in the chapter, the most common basis for sole-sourcing is the belief that prior familiarity with a department or program is a sufficient ground for invoking the uniqueness exemption.)

National Defence tested a call-in information service using departmental employees. After a trial period, the Department decided to continue the service under contract with another organization. Initially, two separate contracts were let on a sole-source basis to an outside organization that then retained the services of two retired departmental employees. Obtaining the services of these particular former employees under the contract was explicitly intended, based on their familiarity with the function.

At the end of the first year a single, two-year contract was awarded to the same organization for the services of the same two people. While on contract, they continued to work out of premises in the Department, and used departmental equipment.

The value of the second contract was about \$265,000, so the Department requested PWGSC to let the contract. Acting on the Department's behalf, PWGSC posted an Advance Contract Award Notice. However, the specifications set out in the Notice (with a strong emphasis on very specific experience

and knowledge) had to be amended before awarding the contract because one of them could not be met by even the selected contractor. The Notice was not reissued, thereby effectively circumventing the process. Although the Department has informed us that it interviewed the two individuals, we are also concerned that the Department did not document this and hence could not provide sufficient evidence about whether and to what extent the selected individuals met all of the specified experience and knowledge requirements for this contract.

By sole-sourcing this contract, the Department does not know whether there are others who could have delivered the service at the same or lower cost. While some experience or knowledge was likely necessary to do the job, the decision to sole-source denied others who might have had relevant experience the opportunity to bid. The decision also ignored the possibility that other firms or individuals might have been willing to absorb the costs of gaining the necessary knowledge in order to win the contract.

Contract control failures

This case illustrates the failure to recognize that a sole-source contract had ended, and that the contractor was continuing to work under verbal authority. This ultimately resulted in the Department issuing another sole-source contract and making a substantial payment without proper authority.

A contractor was issued a \$1.2 million sole-source contract to carry out a study for National Defence. This contract ran from March 1994 until July 1995, when it ended and the contractor was paid. However, the contractor continued to work on the study without a new written contract or an amendment to the expired contract. In December 1995, the contractor submitted an invoice for \$548,000 for work done after July 1995. The Department does not dispute that the work was actually carried out.

The Department did not have the authority to approve a sole-source contract for that amount of money. Therefore, in February 1996 it requested PWGSC, whose approval levels for service contracts were higher, to assist it by arranging for a retroactive confirming order to be issued. Meanwhile, the contractor continued to work without a written contract. In April 1996, still without a written contract, the Department paid the original invoice of \$548,000. Before the contract could finally be regularized in May 1996, work totalling nearly \$1.56 million had been done for the Department.

This is particularly troublesome as it demonstrates that not only did the Department allow the work to continue but it also knowingly paid the contractor more than \$500,000 before the contract was actually signed.

The Department has informed us that as part of its acquisition reform effort, it is continuing to improve its contracting practices. We will be making further inquiries about this case.



Unjustified use of an exemption

This is a case in which a contract let on a sole-source basis did not, in our view, meet any of the exceptions under the Government Contracts Regulations.

The Department wanted advice on a significant financial matter and decided to contract for it. We were informed that tentative approaches were made initially to six potential contractors, all of whom indicated their interest. At that point, rather than solicit bids from the various firms, the Department entered into a sole-source contract with one of them for financial analysis. The contract was valued at \$99,994. There was sufficient time to have run a competitive process. Moreover, financial analysis and advice of the type sought are widely available, as the initial contact with the six firms demonstrates.

The justification for sole-sourcing ultimately selected by the Department was essentially that given the nature of the work, it would not have been in the public interest to solicit bids. The work involved in the contract was straightforward financial analysis. Six firms had already been approached for expressions of interest and hence already knew of the Department's intent; inviting bids from only those six firms could have fully met the requirements for competitive solicitation without widening the circle of knowledge. Thus, for both reasons, in our view the standard required to invoke that exception was not met.

Although the Treasury Board Secretariat's Contracting Policy requires that a complete, documented audit trail be kept for contracts, we also found lack of documentation to support major decisions in this case. Without this documentation it was difficult, for example,

for our audit to determine why that contractor was selected, what work the contractor did, when the work was done and whether the contractor was paid in accordance with the terms of the contract. The substantial daily rates that the government paid for the contractor's services (approximately \$3,000 per person per day) would, in our view, have warranted complete documentation to ensure that the government received the services it paid for. The Treasury Board Secretariat's Contracting Policy states that to ensure that the Crown receives good value where competition is deemed not to be practicable, suppliers are to provide price support/certification. Alternatively, fees should be negotiated on the basis of prevailing rates. The Department was not able to provide any evidence that it had complied with these requirements.

(continued from page 26–9)

Because there was no clear definition of requirements, nearly half of these contracts required amendments.

26.26 We found, however, that actual practice is very different. The five departments we looked at have done some internal audit work on contracting practices, but generally not at a significant level. Further, as we have noted, the most recent government-wide report on contracting activity was for 1995. We asked the Treasury Board Secretariat for its own assessments of departmental compliance, and particularly its reviews of contracts for the services of individuals. We were informed that no such assessments and reviews exist.

Stages of the Contracting Process

Screening to establish and define the need

26.27 The screening process is the stage at which the decision is made that a service is required. It includes developing a clear statement of what the needed service entails. It is also important at this stage to determine whether the

requirement could be met using internal resources instead of a contractor (whether to "make or buy"). We examined the contract files to assess the adequacy of needs analyses, requirement definitions and make-or-buy decisions.

26.28 We found that the files contained only limited information supporting the need for the service to be acquired, no details indicating the relative benefits of make-or-buy decisions and no specific definition of requirements (see Exhibit 26.1). These inadequacies are reflected in some of the problems we observed in our sample of contracts.

26.29 Because there was from the outset no clear definition of requirements — that is, the nature and scope of the tasks to be accomplished — nearly half of these contracts (12 of 26) required frequent amendments that, in many cases, significantly increased their original values. Sometimes the resulting arrangements were not in compliance with the Government Contracts Regulations.

Then senior officials had to become involved to correct the problems.

26.30 Managers advised us that one important reason for not conducting make-or-buy analyses was that the shortage of staff after downsizing has in many cases eliminated "make" as an option.

Deciding whether to sole-source

26.31 Section 5 of the Government Contracts Regulations requires that before *any* contract is entered into, the contracting authority *shall* solicit bids (emphasis added). Section 6 of the Regulations outlines four circumstances in which the contract authority may make an exception and enter into a contract without soliciting bids (that is, enter into a sole-source contract). The Treasury Board Secretariat's Contracting Policy (Section 10.2.2 to 10.2.5) elaborates on these circumstances and provides clear guidance to managers who may want to use an exception to avoid the necessity of soliciting bids (see Exhibit 26.2).

26.32 In Section 10.2.6 of the Treasury Board Secretariat's Contracting Policy we find the following reference:

Any use of the four exceptions to the bidding requirement should be fully justified on the contract file or, where applicable, in submissions to the Treasury Board. Even if a proposed directed contract...for goods and services qualifies under one of these four exceptions, the contracting authority is encouraged, whenever possible, to use the electronic bidding methodology to advertise the proposed award through an Advance Contract Award Notice (ACAN). If there are no valid challenges to the ACAN after fifteen calendar days, the proposed contract is deemed to be competitive and may be awarded using the electronic bidding contracting authority.

Should the contracting authority have to seek the Treasury Board's approval to award such a contract, it should be noted that the Treasury Board cannot approve a directed contract which does not meet at least one of the four exceptions. In such cases, an exception to the Regulations by means of an order-in-council would be required.

When a manager believes that one of the exceptional circumstances exists, the onus is on the manager to show why the exception applies to the contract in question. The manager must formally provide written evidence in the contract file to show the justification for the exception.

26.33 When the uniqueness of the source, for example, is invoked as the reason for sole-sourcing, the guidance makes it clear that management's belief in that uniqueness does not in itself justify the exception. Managers are expected to take positive steps and make inquiries to verify that the source is, indeed, "unique" — that no one else can supply the service. Thus, we expected that the contract files in our sample would clearly identify which of the exceptions had been invoked to justify sole sourcing, and would contain

Guidance makes it clear that management's belief in the uniqueness of a source does not in itself justify an exception to the bidding requirement.

Exhibit 26.1

The Screening Process

Number of contracts in our sample of 26 that met or did not meet our criteria for screening.

Criteria	Met	Not Met
The need for the contract was clearly established and the decision to contract was properly authorized	7	19
There is evidence that meeting the needs from internal resources was considered (whether to make or buy).	3	23
A formal request to contract is on file.	25	1
There is a statement of work requirements that is clear with respect to performance, time, service and expected cost.	9	17
The statement of requirements was approved by an appropriate authority.	18	8

The awarding of these contracts would not withstand public scrutiny.

written evidence of the steps management had taken to verify that an exception was warranted. Exhibit 26.3 sets out in schematic form the logic process that the Government Contracts Regulations require a manager to follow in considering whether a sole-source contract is permissible.

26.34 Advance Contract Award Notices (ACANs) are electronic notices posted on what used to be the Open Bidding Service, now called MERX. This system permits a department to post a notice indicating its intent to award a sole-source contract to a particular supplier. If no one comes forward during the 15-day notice period, the contract goes to the named supplier and the contract is considered to be “competitive”, *even though no competing bids have been submitted*. However, using an ACAN does not exempt the department from the requirement to confirm that the sole-source contract qualifies under at least one of the four stipulated exceptions (Exhibits 26.2 and 26.3).

26.35 Although all of the contracts in our sample were awarded on a

non-competitive basis, we found that only 8 of the 26 had satisfied one of the necessary conditions that make such awarding permissible (see Exhibit 26.4). Indeed, in most instances it was not even clear from the contract file which exception the manager had invoked to justify sole-sourcing the contract.

26.36 We also found that few of the contracts had been advertised using an ACAN, as the policy encourages. Accordingly, too many were awarded without competition. This situation does not reflect the principle of open access to contracting opportunities with the federal government. In our opinion, the awarding of these contracts would not withstand public scrutiny.

26.37 Exhibit 26.5 summarizes the departments’ justification for sole-sourcing in the contract files we reviewed. As it shows, the most common reason for directing the contract to a sole source is “prior experience”. This would imply that departments view a contractor as unique — the only person or organization capable of doing a job — merely by virtue of having had “prior

Exhibit 26.2

Four Permitted Exceptions to Soliciting Bids

The Government Contracts Regulations outline four exceptions; the Treasury Board Secretariat’s Contracting Policy elaborates on these exceptions.

Government Contracts Regulations	Treasury Board Secretariat’s Contracting Policy
Pressing emergency	Emergencies are normally unavoidable and require immediate action. ... An emergency may be an actual or imminent life-threatening situation, a disaster that endangers the quality of life or has resulted in the loss of life, or one that may result in significant loss or damage to Crown property.
Value of less than \$25,000	Specific dollar limit.
Not in the public interest	Should normally be reserved for dealing with security considerations or to alleviate some significant socio-economic disparity.
Only one person (firm) capable of performing the work	Should be invoked only where patent or copyright requirements, or technical compatibility factors and technological expertise suggest that only one contractor exists. This exception should not be invoked simply because a proposed contractor is the only one known to management.

Note: According to the Treasury Board Secretariat’s Contracting Policy, any use of the four exceptions to the bidding requirement should be fully justified on the contract file or, where applicable, in submissions to the Treasury Board.

Source: Government Contracts Regulations (Section 6), and Treasury Board Secretariat’s Contracting Policy (Section 10.2.2 to 10.2.5)

experience". Although the Regulations set a higher standard for uniqueness of source, not one file that we reviewed showed that the department had taken sufficient reasonable steps to confirm that the proposed contractor was unique in its ability to provide the needed service.

26.38 Not only does "prior experience" fail to meet the test of uniqueness but, moreover, its persistent use as a justification for sole-sourcing seriously undermines the spirit and intent of the government's contracting policy. It means that too often the first supplier through the door has an effective monopoly on future business. Used as the basis for sole

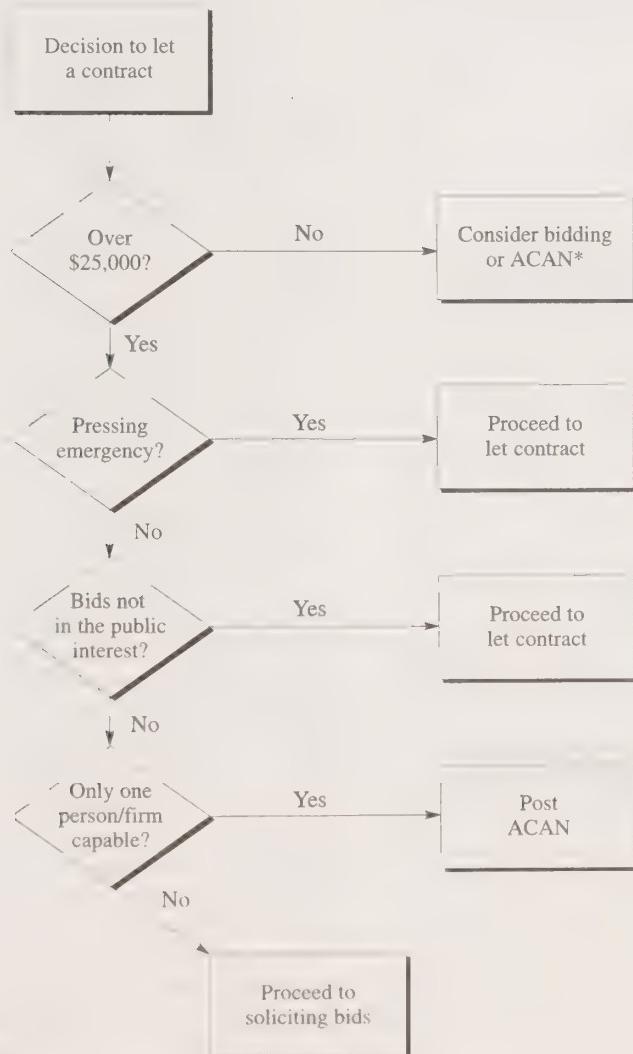
sourcing, prior experience becomes exclusionary: it precludes others from offering new insights or solutions, or even from competing on price by choosing to absorb the cost of the necessary "learning". We note that in no instance where "prior experience" had been invoked did we find evidence of any effort to assess the "value" of this experience to the task at hand. Prior experience was considered justification in itself.

26.39 The apparent disregard for the rules surrounding sole-sourcing that we observed in the cases we audited raises the questions "Why is this so?" and "Are the rules unreasonable or too onerous?" The

Too often, the first supplier through the door has an effective monopoly on future business.

Exhibit 26.3

The Sole-Sourcing Decision Process Required by the Government Contracts Regulations



*ACAN – Advance Contract Award Notice

Source: Government Contracts Regulations

Standing Committee on Government Operations asked these questions in its hearings on sole-sourcing. Addressing this very concern, a senior Treasury Board Secretariat official testified before the Committee as follows:

... So we end up by saying that competition is best and we always strive for competition.

Having said that, why do departments have difficulty in establishing Treasury Board policy? There are a lot of reasons. If you can put yourselves in a departmental perspective or in their shoes for a moment, first of all there is a time constraint. When you go competitive, it is more time-consuming, as a

general rule, than if you sole-source a contract.

Costs are involved. Obviously, time is money. If it takes more time, there are costs associated with that. In a lot of cases it's seen by departments as being an administrative burden. It's not as quick to get a contract out through the competitive process as it is when you sole-source. They have mutually exclusive sub-objectives. A lot of program managers would like to get the program delivery out but not necessarily be concerned with good contracting procedures.

Also, you need a knowledge base and expertise. So you normally have to have an identifiable contracting organization that has sole responsibility for contracting. That's sometimes a constraint on departments, especially ones in downsizing mode. There are limited human resources. We've had significant reductions in our government's workforce over the last several years; hence, limited resources are available for this particular activity. You also need trained and knowledgeable individuals. To train and give that kind of experience to human resources obviously creates some constraints. (Testimony, 26 March 1996)

Exhibit 26.4

Decision to Sole-Source

Number of contracts in our sample of 26 that met or did not meet our criteria for sole-sourcing

Criteria	Met	Not Met
The decision to sole-source or seek bids is clearly recorded.	26	0
The decision to sole-source is in compliance with the Government Contracts Regulations.	8	18
ACAN use justifiable; based on evidence on file.*	2	5

*19 of the contracts in our sample did not involve ACANs – Advance Contract Award Notice

Exhibit 26.5

Reasons Given for Sole-Sourcing the Contracts in Our Sample

Reason	Number of contracts
Prior experience with program or project.	13
Management does not know of another source.	5
Initial value was under the limit (\$25,000 or \$30,000 depending on the date).	3
Not in the public interest.	3
Other.	2

26.40 While testimony before the Committee indicated that departments perceive these rules as constraints, it also pointed out why the rules are in place (for example, to comply with the terms of domestic and international trade agreements). The testimony certainly provided no comfort for a position that the rules imposed *unreasonable* constraints. After weighing all of the evidence, the Committee issued a report that came down fully in support of the rules. It also supported the use of much more stringent procedures — both in departments and in Treasury Board Secretariat — that would

force organizations to comply with the rules.

Setting up the contract to provide for best price and value

26.41 Sole-sourcing for services (even when justified) leaves vulnerable the government's goal of receiving best value. In contrast, when bids are sought the preparation of a Request for Proposals requires a clear statement of the nature and scope of the work as well as what is to be delivered. Accordingly, the competitive bidding process provides some degree of assurance that the best value will emerge from among the bids submitted. In a non-competitive situation that lacks these elements, it is important that other processes be followed to ensure best value. For example, we looked in the files for management's detailed statement of the work to be done, along with its estimate of the nature, extent and cost of the work. These would permit management to assess whether the proposal submitted by the sole source was reasonable. We expected that management would have ascertained the "going rate" for the services of similarly qualified individuals or firms and used this information in negotiating the rate for the contract. We also expected to find that (as recommended by Treasury Board) there had been some examination of the selected supplier and its cost estimates and, ultimately, a requirement for the supplier to certify that it was giving the Crown its best rate. Finally, we expected to find that before work began, each contract had clearly set out what was to be done by when and at what cost.

26.42 By and large, we did not find what we had expected. In only 9 of the 26 cases (Exhibit 26.1) did we find a fully developed statement of work that included management's estimates of the time and costs to do the work. Often we found that the only detailed statement of work, assessment of time and costs, and definition of deliverables had been

prepared by the selected contractor in response to the department's very summary statement of need.

26.43 Generally, departments did not maintain together in one contract file all the documentation required to substantiate the transactions. Departmental officials told us that there were several "contract files" that, taken together, might contain the required documentation. Separate files were maintained in the departments by procurement staff, the responsibility centre managers and corporate finance. In some cases, those files were neither cross-indexed nor available. Generally, the evidence in the files we did see was neither complete nor sufficient for audit purposes. In some cases, the designated responsibility centre manager could not locate any files.

26.44 Treasury Board Secretariat's Contracting Policy states that the terms and conditions of any contract issued should be in writing, and that the contract should be signed by the authorized departmental officials and the representatives of the contractor as soon as possible after notice of the award to the successful bidder. However, we found that departments had entered into many oral contracts, with formal written contracts signed only well after the work had begun and sometimes after it had been completed.

26.45 Without a written contract that specifies the terms and conditions of the work to be done and contains the appropriate signatures, the Crown is exposed to unknown liabilities. Furthermore, our sample indicated that oral contracts may give rise to problems that require extensive involvement by senior departmental and/or Treasury Board Secretariat officials, and sometimes Treasury Board ministers, depending on the size of the contract needing ratification.

26.46 We found only limited evidence in some of the files to support the contractor's price and/or the contractor's

Departments had entered into many oral contracts, with formal written contracts signed only well after the work had begun and sometimes after it had been completed.

certification of best price. The departments were not able to provide any other evidence that the government was receiving good value.

26.47 As Exhibit 26.6 indicates, in only 5 of 26 cases were we provided with reasonable evidence that management had been able to look at the contractor's proposal and assess whether the estimated time and costs were reasonable, given the nature and scope of the work to be done. In only one case were we presented with evidence that management had known the "going rate" and used it in negotiations with the supplier. However, in a fifth of the cases (5 of 26), management had required certification of best price by the supplier. At least in those instances, some assurance was provided on price — if not on value.

Ensuring delivery in accordance with the terms of the contract

26.48 We examined the contract files for evidence that the contractor had carried out the work in accordance with the contract specifications, on time, and at the agreed cost. Our audit criteria were based on the Government Contracts Regulations and the Treasury Board Secretariat's Contracting Policy.

26.49 We found that the deliverables — what the contractor did — were

generally described in intangible terms (such as "advice", "professional services"). Most contracts did not specify clearly what service was required and over what time period. In 21 of 26 cases departments were able to provide us with copies of suppliers' invoices and sign-offs certifying that services had been rendered in accordance with the contract conditions. But other documentation in the files was limited. For nearly two thirds of our sample (17 cases), departments could not provide additional evidence, as stipulated in Section 16.11 of the Treasury Board Secretariat's Contracting Policy, that the deliverables specified in the contract had been provided in full and on time (see Exhibit 26.7). Consequently, management is unable to provide assurance that services in those 17 cases were rendered according to all the terms of the contracts and that funds were disbursed for the purposes intended.

Amendments can compromise open access

26.50 Amendments were another element of contract management that was of considerable concern to the Standing Committee on Government Operations in its inquiry on contracting. The Committee said that tighter controls were required to ensure that amendments were issued only when truly warranted. It wrote:

Our Committee shares the Treasury Board concern over the large volume of contract amendments. In many cases, the amendments are necessary and justified; in others, cost overruns have occurred as a result of weak project management and poor financial controls. Our Committee believes that tighter monitoring of contract performance should be enforced by Treasury Board and the contracting authority within departments and agencies.

26.51 We examined our sample of contract files for evidence that a duly executed contract had been on file when

Exhibit 26.6

Setting Up the Contract

Number of contracts in our sample of 26 that met or did not meet our criteria for setting up the contract to provide for best price and value.

Criteria	Met	Not Met
The amount of work proposed by the contractor was examined and determined to be commensurate with the intended scope of the work.	5	21
Prices were negotiated based on documented knowledge of the "going rate".	1	25
Price support or certification was provided by supplier.	5	21

amendments were made, and that the amendments had been properly justified and approved in accordance with Treasury Board policy. We also assessed whether the amendments were in the “best interest of the government” and were neither the result of poor contract planning nor a means of circumventing other contracting rules.

26.52 As Exhibit 26.7 shows, for about half of the cases involving an amendment, we were provided with insufficient evidence to determine whether or not the amendment had been justified and properly executed. In files that contained enough evidence to make a judgment, for the most part we found that amendments had been neither justified nor properly executed. This often resulted in retroactive changes to contracts. Senior departmental officials, the minister, and sometimes the Treasury Board then had to become involved to rectify, amend, certify and ratify.

26.53 In our opinion, poor planning of procurement, inadequate needs analysis and poor definition of requirements contribute greatly to the often complex and expensive process of changing the original contract. Furthermore, amending contracts instead of soliciting new bids compromises both public scrutiny of the spending of public funds and open access to contracting opportunities for other suppliers.

Conclusion and Recommendations

26.54 In its report, the Standing Committee on Government Operations began its discussion of sole-source contracts by stating firmly that “competition is best”: it has proved to provide the best combination of value and price. The report observed that the proportion of sole-source contracts had been too high for too long, and that the situation had to be corrected. The

Committee did not question the rules surrounding sole-sourcing; it called for strict adherence to them.

26.55 Our 1997 Report Chapter 6, Contracting Performance, noted that many of these rules were in place to respond to the government’s legal and treaty obligations in the conduct of its business. It also noted the need to ensure that contracting practices avoid both the substance and the appearance of preference or patronage. As we observed, government contracting “must cope with these additional expectations without being able to use some of the more aggressive — or more co-operative — contracting tactics ascribed to some private sector organizations, and without incurring excessive administrative costs.” We noted that while the rules for government contracting are different, they are consistent with the broader legal and policy obligations that government managers must meet.

Poor planning, inadequate needs analysis and poor definition of requirements contribute greatly to the often complex and expensive process of changing the original contract.

Exhibit 26.7

Contract Delivery

Number of contracts in our sample of 26 that met or did not meet our criteria for ensuring delivery in accordance with the terms of the contract (14 of the contracts did not involve amendments).

Criteria	Met	Not Met
Certification that the services were delivered as specified in the contract (sign-off under section 34, FAA*) was on file.	21	5
Evidence on file that deliverables specified in the contract were provided at stipulated costs, quality and timeliness.	9	17
Contract amendments were properly justified and approved.	7	5
Contract amendments were in the best interest of the government (e.g. not caused by poor contract planning or established with the intent of contract splitting).	5	2

*FAA – Financial Administration Act

26.56 The Treasury Board Secretariat's Contracting Policy requires that government contracting be conducted in a manner that will:

- stand the test of public scrutiny in matters of prudence and probity, facilitate access, encourage competition, and reflect fairness in the spending of public funds;
- ensure the pre-eminence of operational requirements; and
- support long-term industrial and regional development and other appropriate national objectives.

26.57 The results of our present audit suggest that these requirements are not being met. The managers entering into these contracts may well have had the view that expedience — “getting on with the job” — was sufficient justification for deciding largely to ignore the rules. But in our view, they did not exhibit the prudence necessary to protect the Crown’s interests when entering into a non-competitive relationship with a supplier. Prudence involves such things as clearly defining what is to be done and the resources that the task ought to consume, having a good knowledge of the “going rate” for the service to be purchased, and requiring certification of “best price” from the supplier. Finally, while the need to “get on with the job” may have been the basis for sole-sourcing many or most of these contracts, we found scant evidence of the “job that got done.”

26.58 In the past, we have made many recommendations to the government for improving contracting practices. Essentially they can be reduced to one: follow the existing rules. That is also the essence of the Standing Committee’s recommendations: their general focus in the areas covered by our audit was on the need for additional controls to try to ensure that government managers follow the contracting rules. Nonetheless, based on our sample, breaking the rules in letting sole-source contracts seems to be

widespread. Perhaps this is because it seems to bring few consequences. Introducing new controls over contracting does not seem to be the solution; it would only add to the sense of constraint that many managers feel, and adding steps to the contracting process would increase the time it takes. In turn, some managers would see the added time as added justification for ignoring the rules and “just getting on with it.” The answer may lie in demanding more accountability for the full range of considerations involved in public sector procurement.

26.59 Deputy ministers should ensure that those to whom they delegate contracting responsibilities fully understand the dual objectives of government contracting policy (open access and best value) and are held accountable for adherence to them.

26.60 Deputy ministers should ensure that when contracts are sole-sourced, the circumstances are fully consistent with the provisions of the Government Contracts Regulations.

Government’s response: We wish to thank the Office of the Auditor General for this audit of contracting for professional services.

We are committed to providing departments with leadership to implement sound practices in contracting throughout the federal government. In this regard, we will consider the findings of the audit in our work to improve federal contracting for services.

National Defence’s response: Policies currently in place within the Department of National Defence clearly reflect the government’s dual policy objectives of providing open access to, and obtaining best value from, the contracting process. These policies have recently been reviewed and requirements will be reconfirmed in the very near future. The new policy statement will re-emphasize that sole-source contracts must fully conform to the requirements and

Breaking the rules in letting sole-source contracts seems to be widespread.

circumstances detailed in the Government Contracts Regulations.

In addition to policy statements, departmental training programs already exist to ensure that individuals delegated contracting authority fully understand their duties and obligations. In National Defence, contracting authority is not delegated until such training has been successfully completed.

As a final point, this Department is concerned that the limited sampling technique employed in the conduct of this audit has led to conclusions that may not be representative of department-wide contracting practices. It is acknowledged that sole-source contracts represent a potentially contentious area of contracting, but it remains the intent of this Department to consistently and uniformly apply existing regulations throughout the process.



About the Audit

Objective

The objective of our audit was to examine compliance with the rules for contracting in a sample of sole-sourced contracts for professional services selected from five departments, and to report to Parliament on the results of that work.

Scope and Approach

We examined the policy and framework responsibilities of the Treasury Board Secretariat and Public Works and Government Services Canada — their performance in setting the framework for government contracting and in providing leadership and direction to the rest of government. These responsibilities derive from:

- section 7 of the *Financial Administration Act*, which authorizes Treasury Board to act on behalf of Cabinet in matters of common administration, including the inherent right of ministers to buy goods and services; and
- section 7 of the *Public Works and Government Services Act*, which directs the Minister to plan and organize the provision of goods and services.

We based our examination of the accountability framework on the criteria described in Appendix B of this chapter. We used the criteria to assess information derived from:

- an analysis of the provisions of the policy itself, focussing on the Treasury Board Secretariat policy documents together with those of Public Works and Government Services Canada and five other departments;
- testimony and proceedings of the standing committees on Government Operations and Public Accounts; and
- interviews with officials in Treasury Board Secretariat, Public Works and Government Services Canada, and five line departments.

To examine the results achieved by those working within the policy framework provided by Treasury Board and Public Works and Government Services Canada, we considered the information from the above sources, in addition to:

- review and analysis of the government's contracting and public accounts data;
- analysis of documents provided by, and discussions held with, officials in Correctional Service Canada, Fisheries and Oceans, Health Canada, National Defence, and Transport Canada; and
- analysis of more than 45 professional service contracts presented in 26 cases, for which five departments made payments totalling \$16 million.

To choose the cases, we asked the departments to provide lists of sole-source contracts let in 1996 in amounts over \$25,000 for professional services that were non-material in nature. From those lists we selected up to 10 cases in each department and vetted them to ensure that they met our selection criteria. In each department, the intent was to select the first five cases that met the criteria. Ultimately, we looked at four cases in one department, six cases in each of two departments and five cases in each of two other departments, for a total of 26 cases.

The audit did not assess either the performance or the qualifications of the suppliers. No comments in the report should be construed as criticism of the suppliers.

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Appendix A

Government Contracting, Report of the Standing Committee on Government Operations — Extract

April 1997

I. Introduction

The Standing Committee on Government Operations has been examining the various aspects of government contracting for goods and services within the federal jurisdiction over the last two years. As a Standing Committee of the House, it saw the need to assure Parliament that government contracting is competitive; is accessible to all sizes of business in all regions of Canada; and that it is managed and operated by officials with due regard for economy, efficiency and effectiveness. As a consequence, this means that goods and services contracted out to Canadian businesses in all regions of Canada by the Government of Canada must reflect, among other things, the most economic price, value for money, the efficient delivery of services, and the realization of the Government's financial and budgetary goals.

Our Committee has noted in a recent Treasury Board report that approximately \$8.6 billion was spent by the Government of Canada in fiscal year 1994–95 on contracting activity. Of this amount, over \$3.2 billion (or 37%) for that fiscal year was for sole source or non-competitive contracts. This has been a major concern for the Treasury Board and our Committee and contrary to the government's contracting policy to encourage competition, easier access to government business, fairness and transparency in the contracting process. Our Committee therefore undertook to examine this.

To undertake this study, our Committee invited expert witnesses from federal government departments and agencies, business, labour unions and academic. Over a two-year period, 39 hearings were held; and over 68 briefs and papers were received.

The study was divided into three phases: in the first, our Committee considered the wide scope and definition of contracting in the public sector which in turn led to the identification of several problems and concerns in government contracting in the federal system. The second phase examined the competitiveness or non-competitiveness of government contracting, sole source contracts, the Open-Bidding Service, and the problems relating to small and medium-sized enterprises (SME'S) contracting with the Government of Canada. In the third phase, our Committee challenged the Government with some early findings and recommendations, and subsequently received some favourable and positive responses. As a result, much progress has been made by the Government to improve the government contracting process and introduce new measures in departments and agencies to reduce and control spending in government contracting.

With this report, our Committee recommends further action to be taken by the Government to improve the government contracting process.

II. Summary of Major Conclusions

1. Much progress has been achieved by the Government in improving its contracting policies, procedures and practices over the last two years through our Committee's action and greater public awareness. However, there is much more to be done as reflected in the conclusions that follow.
2. The Treasury Board is not enforcing its policies, directives and guidelines for the approval and execution of contracts by departments, agencies and Crown corporations that fall within its jurisdiction.

3. There is a general lack of public awareness of the federal government's contracting process in many sectors of the Canadian economy, including the small and medium-sized enterprises (SME's) as well as a general lack of understanding of how to access it.
4. The Open-Bidding Service (OBS) does not serve adequately the needs of both the private and public sectors; for many firms, there are difficulties of access, cost, transparency and fairness; for many government departments and agencies, it is more economic and efficient to select bidders on a competitive basis from their respective specialized source list of contractors and suppliers.
5. There is an over-proportionate volume of awards of sole source contracts by departments and agencies, thereby reducing competition in the private sector for government business.
6. There is an increasing use of contract amendments in most government departments and agencies which has led to unnecessary cost overruns.
7. The Government does not have an adequate database for government contracting that can serve both the public service management needs and Parliament.
8. The annual reporting by the Treasury Board Secretariat (TBS) of contracting activity in government departments is inadequate and not timely for parliamentary review.

III. Summary of Recommendations

1. The Standing Committee on Government Operations recommends that TB contracting policies be strengthened and enforced in the following ways:
 - (a) contractors/suppliers be paid no later than 30 days after billing (now implemented);
 - (b) the cut-off for non-competitive contracts be reduced from \$30,000 to \$25,000 (now implemented);
 - (c) it should be mandatory that all such contracts over \$25,000 be open to competitive bidding on the OBS, subject to the exceptions already outlined in TB policy;
 - (d) exceptions must be reviewed with the aim of reducing the number of times they are used to bypass the competitive process;
 - (e) strong sanctions be imposed to prohibit "contract splitting";
 - (f) TBS should ensure that all departmental managers and appropriate staff have the necessary knowledge and training in contract administration so that government contracting policies and practices are well understood and executed by all;
 - (g) the drafting of contract requirements must avoid "contract tailoring";
 - (h) that TBS and PWGS Canada draft a Code of Conduct or a Code of Past Practice for government contracting, and establish contract review mechanisms or boards in each agency.
2. Our Committee recommends an initiative called "Contracts Canada" be created within PWGS Canada to:

- (a) heighten awareness and access for small and medium-sized enterprises (SME's) interested in learning how to do business with the federal government;
 - (b) act as an office of inquiries for businesses who have problems with the contract bidding process or need more detailed information about government contracting;
 - (c) consider establishing an office of an ombudsman (similar to that of the banking industry) for dealing internally and independently with specific contract problems experienced by private businesses and government agencies;
 - (d) launch a public awareness campaign across Canada to inform businesses (including SME's) how to get involved in government contracting;
 - (e) advertise the rotation system currently in place to inform all businesses how to get on the source lists of federal departments and agencies;
 - (f) to simplify and/or decrease the paperwork involved in government contracting procedures and practices.
3. Our Committee recommends that the current Open-Bidding Service (OBS) be completely revised to improve access, competition, transparency and fairness and that the specifications for the new OBS in 1997 take into account improvements in the following areas:
- (a) the continual need to reduce costs and subscriber fees for businesses (particularly SME's) to compete for government contracts;
 - (b) bid solicitation information should be packaged more concisely and efficiently to avoid wasting time and the scarce resources of bidders;
 - (c) choice of service levels needs to be increased through improved electronic bid sets, better database search software and lower telecommunications costs;
 - (d) partnerships with other database access services should be entered into to offer suppliers a choice of other value-added service offerings;
 - (e) cheaper alternative electronic means for advertising government contracts to a wider clientele should be continually upgraded to take advantage of technological improvements and to reduce costs.
4. Our Committee recommends that:
- (a) Treasury Board ensure that all sole source contracts, prior to approval, be examined by contract review mechanisms or boards within each department and agency to ensure that competition, access, transparency and fairness are being promoted;
 - (b) all cases of exceptions or non-compliance with the Government Contracts Regulations be reported back to the TBS and the Auditor General; and
 - (c) the Auditor General conduct periodic audits in those departments and agencies where sole source contracts are awarded regularly on an exception basis or where there has been non-compliance with the Government Contracts Regulations.

5. Our Committee recommends that:

- (a) Treasury Board request all departmental heads to establish a senior management committee to review all contract amendments within their jurisdiction and to monitor more closely the activities giving rise to such amendments;
- (b) where justified, contract amendments should be broken down into sub-categories — e.g. cost overruns, legitimate contract add-ons etc. — in order to reduce significantly unnecessary cost overruns;
- (c) these amendments sub-categories should have varying tolerances set by Treasury Board. Ten percent is recommended as a guideline for specific cost overruns.

6. Our Committee recommends that the Treasury Board:

- (a) in conjunction with PWGS Canada and other departments, continue to improve a standardized reporting framework so that an accurate database for all contracting activity in the government will be established;
- (b) place a high priority on eliminating information gaps in government contracting activity by requesting data from departments on competitive and non-competitive contracts, sole source contracts, contract amendments and justifications;
- (c) place a high priority on issuing an annual report to Parliament on government contracting activity on a timely and regular basis.

Final Recommendation

Our Committee recommends that the Government implement all the above recommendations and report on the progress of implementation to the Chair of the Committee before March 31, 1998.

Appendix B

Criteria and Results Indicators for Contracting

The criteria that we applied are set out below, together with the supporting subcriteria and quantitative results indicators considered. They were developed during our 1997 audit of contracting performance (1997 Report, Chapter 6), reviewed with managers and other stakeholders, and agreed to by Treasury Board Secretariat and Public Works and Government Services Canada.

Criterion	Subcriteria	Results Indicators
Screening. The extent to which contracting screens out requests for goods and services that are unacceptable, unduly expensive, or unnecessary, so that the federal government buys — with integrity — only what it needs.	<ul style="list-style-type: none"> • The extent to which “needs” are separated from “wants” • The extent to which contracts reflect requirements • The extent to which restricted or prohibited transactions are detected and prevented 	<ul style="list-style-type: none"> • requisitions rejected, advice given (taken and rejected) • changes in specifications or source strategy • savings achieved • prohibited or unauthorized transactions processed (negative) • amendment rates (poor specifications)
Competition. The extent to which competition (when used) is open, fair and gets good value.	<ul style="list-style-type: none"> • The extent to which competition is used • The extent to which prices are negotiated when competition is not practicable • The extent to which competition attracts the best qualified suppliers • The extent to which the government treats fairly those who compete • The extent to which competition secures savings (or better value) 	<ul style="list-style-type: none"> • new suppliers attracted • turnover of supplier pool • number of bidders and bid spread • quality assurance reviews • rate of complaints and disposition
Delivery. The extent to which government contracting delivers what was agreed, when it was agreed, and for the price agreed.	<ul style="list-style-type: none"> • The extent to which the government gets what it contracts for (in terms of cost, quality and time) • The extent to which suppliers get what they contract for 	<ul style="list-style-type: none"> • payment certifications • contractor evaluations • amendments • contract audit results • supplier sanctions and incentives applied

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Report of the
Auditor General
of Canada
to the House of Commons

Chapter 27
Grants and Contributions: Selected
Programs in Industry Canada and
Department of Canadian Heritage

December 1998

Report of the
Auditor General
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Chapter 27
Grants and Contributions: Selected
Programs in Industry Canada and
Department of Canadian Heritage

December 1998

This December 1998 Report comprises 11 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, September and December 1998 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

Chapter 27

Grants and Contributions

**Selected Programs in Industry Canada
and Department of Canadian Heritage**

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. The numbered paragraphs in bold face represent recommendations.

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Grants and Contributions

Selected Programs in Industry Canada and Department of Canadian Heritage

Main Points

27.1 The Office of the Auditor General considers the proper management of grants and contributions to be an important part of good public administration within the federal government. Accordingly, the chapter presents:

- an overview of the use of grants and contributions by departments;
- highlights of the Office's observations over the past 21 years on the value for money in grant and contribution programs;
- a performance management framework that we are developing for grant and contribution programs; and
- the results of an audit, using aspects of this framework, of selected grant and contribution programs in Industry Canada and Canadian Heritage.

27.2 Our audits of the management of grant and contribution programs over the past 21 years have produced a long series of consistent observations: problems in compliance with program authorities, weaknesses in program design, instances of poor controls, and insufficient performance measurement and reporting. Overall we have continued to find the same problems. There are many reasons why these problems have persisted. They range from decision-makers not following the rules governing expenditures on grants and contributions to weak management practices. To address this latter problem, our Office is developing a performance management framework.

27.3 We found that there are significant opportunities to improve the management of the programs we audited:

- For the Ontario Base Closure Adjustment Program delivered by Industry Canada, there was little evidence that the Department exercised due diligence in approving funding for many projects.
- We had similar concerns about Canadian Heritage's Multiculturalism Program. In about one third of the projects we audited, there was little evidence that the Department had exercised due diligence in approving funding. We are also concerned that the Program's performance expectations are ambiguous; clarification is needed to avoid duplicating the efforts of other departments and of provincial governments.

27.4 We also examined indirect delivery arrangements where a department contributes funds to an external organization that, in turn, distributes funding to the intended recipients. These arrangements require special accountability measures since departmental managers cannot rely on direct supervision and adjustment to achieve expected results. We found that Industry Canada could strengthen accountability for performance under its contribution agreements with CANARIE Inc. (Canadian Network for the Advancement of Research, Industry and Education) and PRECARN Associates Inc. (Pre-Competitive Advanced Research Network).

Introduction

27.5 The provision of grants and contributions to individuals, businesses and not-for-profit organizations is one of the most important ways that the Government of Canada pursues its program objectives.

27.6 Accordingly, the chapter presents:

- a brief overview of the Office's observations over the past 21 years on value for money in grant and contribution programs;
- a performance-oriented management framework that we are developing for grant and contribution programs and that we will use again in future audits; and
- the results of an audit, using aspects of this framework, of selected grant and contribution programs in Industry Canada and Canadian Heritage.

An overview of grant and contribution programs in the federal government

27.7 Grants and contributions are part of the category of expenditures known as transfer payments. Transfer payments are transfers of money from the federal government to individuals and to organizations of various types, including businesses or other governments.

27.8 Grants are unconditional transfer payments for which eligibility and entitlement may be verified. If an individual or organization is eligible for a grant, the appropriate payment can be made without requiring the recipient to meet any future conditions. In contrast, the payment of a contribution is subject to performance conditions that are specified in a contribution agreement. The recipient must continue to show that these conditions are being met in order to be reimbursed for specific costs over the life of the agreement. The recipients' use of contributions can also be audited by the

government, whereas this is usually not a requirement for a grant.

27.9 Because there is generally less accountability required for grants, we have argued for many years that they ought to be reserved for situations where they are truly unconditional or where they can be administered more cost-effectively than contributions.

Planned spending for 1998–99

27.10 The Main Estimates and Supplementary Estimates A for 1998–99 indicate planned spending of \$39.5 billion on grants and contributions by departments and agencies, \$23.1 billion of which are grants made by Human Resources Development Canada. (See Appendices A and B for a summary of planned expenditures on grants and contributions by all departments and agencies.) This total spending includes both statutory and voted (or discretionary) expenditures. Statutory expenditures are those that have been given continuing authority by acts of the current or previous parliaments and therefore require no new parliamentary approval. Voted expenditures are those for which parliamentary authority is sought through an annual appropriation act.

27.11 This chapter addresses issues surrounding the management of voted grants and contributions and not statutory ones, over which managers have little discretion.

Selected observations in previous audits

27.12 We have reported to Parliament on numerous audits of grant and contribution programs over the past 21 years. Many of those audits identified similar concerns. What follows is a brief discussion of the key messages of those audits.

27.13 **Government-wide.** In 1977, we reported on a two-year review of grant and contribution programs of 20 departments

Grants and contributions are among the most important ways that the Government of Canada pursues its program objectives.

and agencies. Our observations fell into four broad categories:

- inconsistent application or interpretation of government policy on grants and contributions;
- inefficient use of funds and inadequate measures to ensure accountability by program recipients;
- lack of control, monitoring and evaluation; and
- reporting in the Estimates and the Public Accounts that was inadequate to facilitate examination and year-to-year comparisons by Parliament.

27.14 In 1984, as guidance to audit staff, we identified eight critical management processes for grant and contribution programs:

- stating objectives clearly;
- establishing unambiguous terms and conditions;
- informing potential applicants of program guidelines;
- reviewing and approving applications diligently;
- making payments properly;
- monitoring individual grants and contributions appropriately;
- providing good information to management; and
- assessing program effectiveness.

These processes became the basis for subsequent value-for-money audits during the 1980s.

27.15 Department of Regional Industrial Expansion. In a 1985 audit of the direct assistance programs of the Department of Regional Industrial Expansion, we reported a number of weaknesses in control processes and program delivery practices. We recommended documented assessment

guidelines and controls to ensure that project approval processes across the country were consistent and that funded projects met program eligibility requirements and objectives. We also recommended that departmental guidelines on assessing the need for support be strengthened and that the analyses of selection criteria be part of the case file documentation. In 1987, we followed up on the status of these recommendations. Although the Department had strengthened many of its procedures, aspects of project eligibility continued to be a problem and more specific guidelines for determining eligibility still did not exist.

27.16 Canada Employment and Immigration Commission. In 1986, as part of an audit of the Canada Employment and Immigration Commission, we suggested that because grants require no monitoring of recipients' performance, their use ought to be minimized. We recommended that departments and agencies be authorized to use this funding mechanism only where it can be clearly demonstrated that it is a more cost-effective way of achieving program objectives.

27.17 Indian Affairs and Northern Development. In 1988, as part of our audit of the Department of Indian Affairs and Northern Development, we reported ongoing concerns about the implementation of contribution agreements with Indian bands and organizations. These long-standing concerns were in two main areas: the release of funds before complete documentation requirements had been satisfied, and inadequate monitoring of band operations to ascertain whether funds were being spent for the purposes intended. We recommended, among other things, the development of a financial policy framework that encouraged good management of funding arrangements.

27.18 Secretary of State. In our 1990 audit of Citizenship Development

Programs of the Department of the Secretary of State, we identified the need to establish criteria for evaluating applications and results against program objectives. This was consistent with earlier observations concerning the need for departments to put more effort into monitoring and assessing program results.

27.19 Industry, Science and Technology. Also in 1990, we reported instances where the Department of Industry, Science and Technology had not exercised due diligence. Our work uncovered cases where projects were approved despite initial departmental analysis indicating that they did not meet eligibility criteria. We also observed cases where the financial support to a project was more than departmental analysis identified as necessary. Little or no documented rationale was available to explain these decisions.

27.20 Fisheries and Oceans. Our 1993 audit of the Northern Cod Adjustment and Recovery Program administered by Fisheries and Oceans revealed some significant weaknesses. We reported the lack of a clear legislative authority to deliver the program, significant difficulties in targeting payments to those closely affected by the moratorium on fishing northern cod, payments to individuals who did not meet eligibility requirements, and weak financial management and controls. We recommended clarification of the legislative authority for the program and consequential amendment of the terms and conditions and administrative procedures.

27.21 Industry Canada / regional development agencies. In 1994 and 1995, we audited a number of contribution programs delivered by Industry Canada and by the federal regional development agencies (Atlantic Canada Opportunities Agency, Federal Office of Regional Development—Quebec and Western Economic Diversification Canada). We

noted weaknesses in different aspects of program delivery, including lack of due diligence in project assessment. Our recommendations included:

- more persuasive assessments to support funding decisions, and documentation that reflects all the major factors supporting decisions to approve assistance;
- the streamlining of guidelines and criteria for assessing applications, differentiated by size and risk, and simplification of application documentation for small projects;
- better co-ordination with other federal and provincial departments in view of the potential for duplication of effort and funding; and
- greater attention to collecting repayable contributions.

27.22 In summary, our audits of the management of grant and contribution programs over the past 21 years have produced a long series of consistent observations. Our 1977 audit found problems in compliance with program authorities, weaknesses in program design, instances of poor controls, and insufficient performance measurement and reporting. Subsequent audits have made similar observations. While we have found signs of specific improvements in some areas when we followed up on these audits, overall we have continued to find the same problems each time we have audited grant and contribution programs.

27.23 An obvious question is why have these problems persisted? There are, of course, many reasons, some of which have to do with situations where decision-makers simply have not followed the rules governing expenditures on grants and contributions. There are other reasons, however, having to do with weak management practice. In particular, setting clear, attainable goals, exercising due diligence and measuring performance have continued to be challenges for

Our audits of the management of grant and contribution programs over the past 21 years have produced a long series of consistent observations.

program managers. Accordingly, our Office is developing a performance management framework for grant and contribution programs that we hope will help managers manage better.

A performance management framework: helping managers manage better

27.24 We are developing the framework for several reasons:

- It provides us with a way of summarizing our views on good management of grant and contribution programs, based on more than 20 years of value-for-money audit work in this area.
- It sets out our expectations of management — in other words, what we will be looking for in future audits of grant and contribution programs.
- Perhaps most important, it is designed to help departmental managers think critically about their programs and consider how best to manage them.

27.25 Exhibit 27.1 shows an initial list of the qualities of a well-managed grant or contribution program. Each quality is a product of a well-designed management system and of good practices. In fact, these qualities correspond closely to the key controls we have looked for in

previous audits. In the framework, we hope to encourage managers to move beyond control in and for itself to a broader view of performance. The qualities also embody the key principles of accountability, the criteria for performance reporting, and the elements of the framework for managing for results recently developed by our Office.

27.26 The performance management framework complements existing Treasury Board policies and previous statements by our Office on the management and control of grants and contributions. It does not attempt to replace or repeat them.

27.27 We intend to continue developing this framework and will present it in a future report along with guidance for program managers on risk assessment.

Focus of the audit

27.28 The focus of our audit was to determine whether there were significant opportunities to improve the management of specific programs in Industry Canada and Canadian Heritage. The audit also provided us with the opportunity to apply our performance management framework for grant and contribution programs.

27.29 In particular, this audit brings attention to what constitutes due diligence in assessing applications for grants or

Exhibit 27.1

Qualities of a Well-Managed Grant or Contribution Program

- The choice of funding instrument – grant or contribution – respects accountability to Parliament and achieves a balance among principles of cost-benefit, risk management, and reasonable treatment of program recipients.
- Management can explain how recipients are expected to benefit from funding and to what end.
- Program officers understand who and what is eligible for funding, under what conditions funding can be provided, for what purposes, and in what amounts.
- Potential applicants are aware of the program.
- Eligible projects represent value for money to both the applicant and the program.
- More deserving recipients are funded and at an appropriate level.
- Funding is used for the purposes agreed.
- Problems with project and program performance are resolved quickly.
- Management reporting demonstrates a good knowledge of program performance.
- Money owed to the Crown is collected promptly (in the case of repayable contributions).

contributions. In our view, the assessments supporting decisions to make grants and contributions need to be as thorough as the circumstances require and they need to be documented so that subsequent review and performance measurement is possible. Due diligence does not imply exhaustive analyses in all cases; it simply means ensuring that funding decisions take all of the criteria set by the Treasury Board and a department into account and that they are based on reliable information.

27.30 We selected programs for audit that deal with economic and social development issues — Ontario Base Closures Assistance Program and the Multiculturalism Program respectively. These programs are delivered by departments directly. We also selected examples of indirect delivery — Industry Canada's contribution agreements with Canadian Network for the Advancement of Research, Industry and Education (CANARIE) and Pre-Competitive Advanced Research Network (PRECARN) since this approach is becoming increasingly common.

27.31 Further details on the audit are found at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

DIRECT DELIVERY OF GRANT AND CONTRIBUTION PROGRAMS

Industry Canada: Contributions Under Ontario Base Closure Adjustment Program (OBCAP)

27.32 In 1994, the government announced the closing of a number of military bases across Canada. A federal strategy was prepared, assigning

responsibilities to several departments to help communities affected by the closures.

27.33 In Ontario, bases in North York, Ottawa and London were to be closed while those in North Bay and Kingston were to be reduced in size. As part of the government's strategy, Industry Canada is responsible for providing advice to affected communities and for managing the Ontario Base Closure Adjustment Program (OBCAP), which funds initiatives for economic development and diversification. The base in London involves the transfer of lands to an Aboriginal band and is not included under OBCAP.

27.34 The objective of OBCAP is to help affected communities deal with the economic impacts of military base closures. The program is aimed at helping communities undertake studies of economic development opportunities and implement economic development measures. To be eligible for support under OBCAP, proposed projects must have the potential to address the economic development needs of affected communities and must have broad community support. The Treasury Board requires that potential projects be assessed on the basis of the following criteria:

- degree of community support;
- degree of innovation in the project;
- degree of risk in the project;
- likelihood that the project would not proceed without federal support;
- potential short-term and long-term benefits of the project; and
- cost efficiency and effectiveness.

27.35 OBCAP was given a budget of \$11.7 million for projects over seven years. Exhibit 27.2 shows the allocation of the budget. As of September 1998, there was about \$945,000 left to be disbursed over the next three years.

27.36 We audited 9 of the 19 projects that had been approved between February

Due diligence means ensuring that funding decisions take all of the criteria into account and that they are based on reliable information.

We found little information on file to indicate that the criteria had been considered in the decision to fund several of the projects we reviewed.

1995 and June 1998. These 9 projects represent about 88 percent of the total dollar value of approvals for the whole program.

Weak assessment of projects

27.37 We expected that the Department's files would at least contain an assessment against the criteria set by the Treasury Board justifying the decision to fund each project. However, we found little information on file to indicate that these criteria had been considered in the decision to fund several of the projects we reviewed. In particular, there was little evidence that in these cases Industry Canada officials had assured themselves that the projects represented value for money. Exhibit 27.3 provides examples of two such projects.

Contributions often exceed recommended limits

27.38 The program terms and conditions state that contributions to studies will not exceed 90 percent of the eligible costs, and contributions to economic development projects will not exceed 50 percent. The merit of the proposal and the ability of the applicant to share the cost determine the level of support. The Minister may, in extraordinary circumstances, decide to contribute up to 100 percent of the eligible costs.

27.39 Five of the nine projects that we audited had received funding that exceeded the stipulated levels. In our view, due diligence would have required

that departmental officials assess the extraordinary circumstances that necessitated the higher funding levels. For four of these projects, however, there was no explanation on file to support the decisions to exceed the stipulated level of funding.

Performance information on projects needs to be obtained

27.40 Little information so far on project results. Although the Department's review of the support for claims from recipients was adequate, we found no reports in the files of visits to the sites of the larger projects we looked at. To date, final reports have been prepared for two projects. Those reports included information on the work that was done according to the terms of the OBCAP agreement, but provided no information about the fulfilment of the program objectives and criteria.

27.41 Repayment. The program terms and conditions state that assistance will be subject to the government policy on repayment. However, because similar adjustment programs for base closures across the country did not require not-for-profit organizations to repay the contribution, Industry Canada provided the same exemption under OBCAP.

27.42 Two of the files we audited involved projects through which the applicants, not-for-profit organizations, would realize significant revenues. In our view, there could be merit in the Department considering whether to exempt organizations from repayment on a case-by-case basis after assessing the likely benefits of the project to the applicant.

27.43 Industry Canada should ensure that the projects it funds in its contribution programs represent value for money to both the applicant and the program. In particular, the Department should apply the respective terms and conditions approved by the Treasury Board for its grant and contribution

Exhibit 27.2

Allocation of Budget for Ontario Base Closure Adjustment Program

Community	Allocated Amount
Downsview, North York	\$ 2,100,000
Kingston	\$ 500,000
North Bay	\$ 7,000,000
Ottawa	\$ 2,100,000

Examples of Lack of Project Assessment Against Funding Criteria – OBCAP

In our view, due diligence demands that Industry Canada officials determine whether proposed projects represent value for money to both the applicant and the program by assessing them against the criteria set by the Treasury Board for the Ontario Base Closure Adjustment Program (OBCAP). The following cases are examples of projects for which there was little evidence on file that such an assessment was done.

CASE 1 — United-States Custom Pre-clearance Facility, Ottawa International Airport

Contribution Amount: \$2,000,000 – Non-repayable contribution – 72 percent of the eligible costs.

Status: Project completed in July 1997.

Description: The project involved construction of a temporary U.S. Customs and Immigration pre-clearance facility within the existing air terminal building.

Background: The application for a \$2,000,000 contribution was submitted by a not-for-profit organization, the MacDonald-Cartier Airport Authority, in November 1996. The agreement for OBCAP funding was signed in January 1997. One month later, the Ottawa International Airport was leased out by Transport Canada to the Authority as part of a decision to lease out major Canadian airport operations.

We found that:

- there is little explanation of how this project contributed to the objectives of OBCAP; and
- there is little information on file indicating that the Department assessed the project against the program funding criteria set by the Treasury Board.

It must also be noted that this project received 95 percent of the total budget that was allocated to Ottawa.

CASE 2 — Construction of a Cultural Centre, Scarborough, Ontario

Contribution Amount: \$ 500,000 – Non-repayable contribution – 50 percent of the eligible costs.

Status: Project completed by March 1998.

Description: A not-for-profit corporation constructed a cultural centre. Under the contribution agreement, the \$500,000 could be used for any costs associated with building or equipping the centre.

Background: In September 1996, the not-for-profit corporation applied to OBCAP for a \$500,000 contribution. The total cost of the project was estimated at \$15 million, spread over three phases. The closed base, CFB Toronto, was located in North York; the project was in Scarborough.

We found that program managers had concerns about this project, and, in particular, had no information demonstrating that:

- the closure of the base in North York had an impact on Scarborough; and
- the project in Scarborough would have an economic impact on North York.

As well, there is little information on file indicating that the Department assessed the project against the program funding criteria set by the Treasury Board to determine whether the project represented good value for money.

Despite the recommendation by senior departmental officials that the project not receive any funding under OBCAP, the Department approved the \$500,000 contribution. The rationale on file for this decision was that there would be some economic benefits to the Greater Toronto Area.

With only such broad objectives to guide decision making, the Multiculturalism Program is funding projects that also fall within the mandates of other departments or of provincial agencies.

programs when assessing applications for funding. The Department should document this assessment to provide proper justification for the decision to fund or not fund the project.

Department's response: The Department agrees with the Auditor General on the need to better document project files to demonstrate that the projects comply with the approved terms and conditions. We agree that better application of existing documentation processes in the future will demonstrate that all program terms and conditions are respected.

Department of Canadian Heritage: Grants and Contributions Under the Multiculturalism Program

27.44 The Multiculturalism Program has the mandate "to strengthen Canada by fostering an inclusive society in which people of all backgrounds, whose identities are respected and recognized as vital to the evolving Canadian identity, feel a sense of belonging and attachment to this country."

27.45 In 1997, the Department introduced changes to the Multiculturalism Program; it revised the objectives and decided to eliminate sustaining funding (funding of an organization's ongoing program of activities, including operational costs) over a three-year period. This funding is

being replaced by funding of specific projects that support the program's objectives and priorities.

27.46 In 1997–98, the Department made grants or contributions totalling \$19 million to 1,000 projects under the Program. We audited a sample of 80 grants and contributions authorized between 1 April 1997 and 31 March 1998.

Performance expectations are ambiguous

27.47 The five objectives of the Multiculturalism Program are stated in very general terms (see Exhibit 27.4). While this is not unusual, the Department has not supported them with more clearly stated and focussed goals and expected results. Doing so would have helped to ensure an appropriate choice of projects for funding and to facilitate measurement of the results achieved.

27.48 We found that with only such broad objectives to guide decision making, the Program is funding projects that also fall within the mandates of other departments or of provincial agencies. For example, our sample included the following projects:

- an anti-drug program for adolescents in a particular religious group;
- integration services for new immigrants;

Exhibit 27.4

Multiculturalism Program Objectives

1. Assist in the development of strategies that facilitate the full and active participation of ethnic, racial, religious and cultural communities in Canada.
2. Facilitate collective community initiatives and responses to ethnic, racial, religious and cultural conflict and hate-motivated activities.
3. Improve the ability of public institutions to respond to ethnic, racial, religious and cultural diversity by assisting in the identification and removal of barriers to equitable access and by supporting the involvement of these communities in public decision-making processes.
4. Encourage and assist in the development of inclusive policies, programs and practices within federal departments and agencies so that they may meet their obligations under the *Canadian Multiculturalism Act*.
5. Increase public awareness, understanding and informed public dialogue about multiculturalism, racism and cultural diversity in Canada.

Source: Department of Canadian Heritage

- a promotional tour for a novelist;
- a brochure on alternatives to physically disciplining children, published in 16 languages including French and English;
- a conference to discuss promoting science and technology programs in schools, for a specific racial group; and
- a conference for Aboriginals on adolescent issues.

27.49 Each of these projects has merit in its own right. However, given the issues they address, these projects appear more directly related to the mandates of other federal departments or of provincial or local social services. We found in some of these projects that other departments or provincial services were working directly with the recipient organization, while Canadian Heritage provided most or all of the project funding. There was no information on file explaining why, given the involvement of these other agencies, the Multiculturalism Program was funding the project.

27.50 We understand that the Program encourages partnership in addressing multiculturalism issues. Nevertheless, in our view, the Department needs to ensure that the broad program objectives are supported by sufficiently clear goals and funding priorities and by good practices to ensure that collaboration on projects does not lead to duplication of effort with other federal or provincial agencies.

Concerns about support for funding decisions

27.51 Due diligence requires program staff to assess applications for funding using the eligibility criteria set by the Treasury Board as well as departmental guidelines (see Exhibit 27.5). In our sample of 80 projects, we found a wide range of practices. Many files contained only partial assessments, while others

presented full and persuasive ones. See Exhibit 27.6 for two specific examples.

27.52 The Department's guidelines stipulate that every project considered for funding be clearly linked to:

- the mandate of the Multiculturalism Program;
- one or more of the policy goals; and
- one or more of the objectives, as well as priority issues.

27.53 We found that the justification for funding sometimes referred to the policy goal only, and other times only to the objectives or to the activity type; in still other instances, there was no reference at all to any of these elements of the management framework. In addition, no priority issues were developed for 1997–98, and the Department has not yet approved priorities for 1998–99 to 2000–01.

27.54 In about 30 percent of the files we audited, we could not assure ourselves that departmental officials had exercised due diligence in assessing the project. This is because there was little evidence of a reasonably complete assessment of either the merits of the projects or the rationale for departmental support, or both. For example, we found that for

In about 30 percent of the files we audited, we could not assure ourselves that Canadian Heritage officials had exercised due diligence in assessing the project.

Exhibit 27.5

Multiculturalism Program Eligibility Criteria

To be eligible, all proposals must meet the criteria as listed below:

- Clear objectives and expected outcomes
- A plan to assess the impact of the project and measure its results
- A detailed budget including:
 - an explanation of the need for Multiculturalism funding;
 - a description of how funding will be used; and
 - a listing of financial and resources from other sources
- Involvement of those individuals, or groups, most affected by the activity
- Involvement and assistance of key stakeholders
- A plan to distribute and share knowledge

Source: Department of Canadian Heritage

many projects, there was little information on file to indicate:

- the specific, local, social development issue that the project was supposed to address;
- why the proposed project was a reasonable way of dealing with the issue; and
- why program funding was needed for the project to proceed.

27.55 In addition, we found many projects for which the expected results were not stated in measurable terms or

simply indicated the activity to be carried out, such as “hold a workshop” or “prepare a strategy”. There was often no description of what these activities were expected to accomplish.

27.56 The Program guidelines stipulate that the following kinds of activities are supposed to be excluded from funding:

- regular annual general meetings of an organization or association;
- projects that have already been initiated before an application is made;

Exhibit 27.6

Range of Practice in Exercising Due Diligence – Multiculturalism Program

In our view, due diligence demands that Canadian Heritage officials determine whether proposed projects represent value for money for applicants to carry out and for the program to fund by assessing them against criteria set by the Treasury Board and departmental guidelines. The following cases are examples of the wide range of practice we found in our sample of funded projects.

CASE 1 – Program Objective: Full and Active Participation of All Communities

Grant Amount: \$65,000

Mission of the Organization: The project involves a charitable organization whose mission is “to build strong kids, strong families, strong communities through involvement in programs that develop spirit, mind and body”.

Description: The project aims at the development of strategies for minority participation and leadership in a local public housing area, with special focus on minority youth.

There is evidence that due diligence was exercised in assessing this case because:

- the need for the project is well described;
- there is an explanation of how the project links to the Multiculturalism Program objectives; and
- expected results are identified and supported by clear plans.

CASE 2 – Program Objective: Public Education

Grant Amount: \$10,000, paid December 1997

Recipient Organization: A partnership of community groups

Description: A conference on racism to be held by 31 March 1998

We believe that due diligence was not exercised in assessing this project. While an extensive analysis should not be required for a small grant, we did expect that there would be minimal information on certain key matters. Instead, we found that:

- there was no information on file explaining the specific local problem that would be addressed;
- there were no clear goals or expected results for the conference;
- there was no explanation of why a conference was an appropriate approach; and
- there was no explanation of why program funding was needed for the project to proceed.

- profit-making activities for commercial gain; and
- provision of individual counselling.

We found one or more projects that could be examples of each of these.

27.57 In short, we found that management has not ensured that the assessment process is rigorous and that funded projects demonstrably support the Program objectives and respect its terms and conditions. At the same time, management must meet its responsibilities without requesting more information from applicants than is needed, given the relatively small amounts of some of these grants.

Slow transition to project-specific funding

27.58 As already noted, Canadian Heritage plans to eliminate sustaining funding for organizations and move to project-specific funding. The transition is supposed to take place gradually over the three years ending 31 March 2000. Recognizing that some client organizations might find it difficult to move to a new form of funding, the Department planned to work separately with each organization to develop transition plans by the end of November 1997. However, it did not meet that deadline. For a third of the applicable cases, the transition plan has not yet been developed.

27.59 The authority for the new Program stated that all grants and contributions to organizations other than those that receive sustaining funding would follow the new terms and conditions effective 1 April 1997. However, while draft material was available in advance, documentation for assessing applications under the new Program was not distributed to all staff until June 1998. Our file review indicated that even though the new Program has been introduced, the influence of the old

Program is still evident. In practice, the officers often assess the projects in the same way as before. We also noted that many approved projects tend to reflect goals of the old program rather than the new one.

Monitoring of performance could be improved

27.60 Given the large number of projects and the small individual amounts of money involved, Canadian Heritage has opted to use grants more often than contributions. Nevertheless, the Department often asks grant recipients to provide financial or performance information about their project in order to receive instalment or final payments. These requirements create an incentive for the recipients to describe how the funds have been used and what results have been achieved. However, we noted some cases where payments were made to recipients who had not met these conditions.

27.61 Within two months of the project's completion, a descriptive report of the project is supposed to be forwarded to the Department. However, in a third of the files we audited, we found that these reports had not been provided.

27.62 Since the Program often funds projects of the same organizations year after year, these reports are an important way for program officers to maintain a good knowledge of an organization's performance.

27.63 The Department of Canadian Heritage should:

- further clarify the objectives of the Multiculturalism Program by defining clear, attainable goals and expected annual results;
- ensure that due diligence is exercised in the review and approval of grants and contributions under the Program; and
- ensure that recipients provide the required performance information.

Increasingly, departments provide funding to organizations outside the federal government that, in turn, decide on the ultimate recipients of the money and manage the funding agreements.

Indirect delivery arrangements require special accountability measures.

***Department's response:** The audit reviews the first year of a renewed Multiculturalism Program. As we implement the new directions, we find that the transition is taking more time than anticipated. Voluntary organizations and community groups traditionally funded by the Department to address complex social issues are facing significant challenges in adjusting their resourcing, operations and priorities to the evolving direction of the Program.*

The Department acknowledges the importance of further clarifying program objectives. In this regard, the Department provides: assistance and direction to all program staff in their interpretation of program objectives, approved goals and priorities for 1998–2001; comprehensive reference materials; and training workshops. In the interest of due diligence, renewed emphasis will be placed on the rigorous application of assessment criteria in the review and approval of grants and contributions, concentrating on areas for improvement identified in the audit.

Finally, in keeping with your recommendation that recipients provide the required performance information, we will monitor the results of approved grants and contributions in order to analyze and assess their impacts and effectiveness.

INDIRECT DELIVERY OF CONTRIBUTION PROGRAMS: INDUSTRY CANADA

Accountability for Indirect Program Delivery

27.64 Increasingly, departments provide funding to organizations outside the federal government that, in turn, decide on the ultimate recipients of the money and manage the funding agreements. This kind of arrangement is referred to as indirect program delivery. Such an arrangement complicates the relationship between the

department and program beneficiaries, and demands renewed attention to the principles of accountability to Parliament for the spending of public money.

27.65 We indicated in our recent work on modernizing accountability practices in the public sector that whether a department delivers a program directly or uses an arrangement with an external organization to meet its objectives, the need for accountability does not change.

27.66 Indirect delivery arrangements require special accountability measures, since departmental managers can no longer rely on continuing supervision and adjustment to achieve expected results. In the terms of our performance management framework for grant and contribution programs, management must still satisfy itself that all the qualities are met even though it is not directly managing operations. Consequently, great care is needed in defining objectives and performance criteria in advance. Once a funding agreement is in place, ongoing assessment is required to ensure that performance is in line with expectations and that the external organization exercises due diligence in selecting and managing projects.

Contributions to CANARIE Inc. and PRECARN Associates Inc.

27.67 Our audit scope in examining indirect program delivery was Industry Canada's responsibilities under the contribution agreements with CANARIE Inc. (CANARIE) and PRECARN Associates Inc. (PRECARN). We did not audit the operations of CANARIE or PRECARN, and none of our observations should be interpreted as comments on the performance of either organization.

What is CANARIE?

27.68 The Canadian Network for the Advancement of Research, Industry and Education (CANARIE) is a not-for-profit industry-led consortium created in 1993

with support from the federal government. Its purpose is to accelerate the development of the Information Highway in Canada, and to facilitate development of critical aspects of the communications infrastructure in order to contribute to Canadian technology industry competitiveness in the global economy, to wealth and to job creation.

27.69 CANARIE is governed by a volunteer board of directors and is composed of over 120 fee-paying members from businesses, universities, research institutions and government organizations. CANARIE supports the following type of activities:

- operation and upgrading of CA*net, the backbone of Canada's research Internet;
- the creation of a very high-speed network to allow Canadian companies and researchers to test advanced networking technology;
- programs to support technology development and diffusion, and product and service development; and
- an outreach program to increase awareness and communicate the benefits of an information-based economy in Canada.

27.70 CANARIE activities are proceeding in three phases. Phase 1 (1993–95) cost approximately \$125 million, of which the federal government contributed \$27 million through Industry Canada; Phase 2 (1995–99) will cost more than \$400 million, of which Industry Canada is contributing \$80 million; and Phase 3 is in the planning stage at this time. In 1998, CANARIE was also awarded a one-time grant of \$55 million to help develop a national optical network, which was not covered in this audit.

27.71 CANARIE is not required to repay the federal government's contributions. CANARIE has been

authorized to implement cost recovery agreements with contractors receiving CANARIE support for technology applications development projects and subsequently to retain repayments for use in reducing the amount of the federal contribution for the planned Phase 3 CANARIE activities.

Accountability for program performance could be improved

27.72 We examined the Phase 2 contribution agreement between Industry Canada and CANARIE. The agreement requires CANARIE to submit a business plan and an operating plan. In examining these documents, we found that although they provide performance goals for Phase 2, they do not include annual performance expectations against which the Department could monitor performance of CANARIE activities. We also noted that there was no requirement for annual updates to these plans or for annual performance reports by CANARIE.

27.73 Consequently, we found that Industry Canada does not monitor results achieved annually by CANARIE in a structured way. Although departmental files contain quarterly progress reports for sub-projects, there are no performance reports for core activity areas or for CANARIE activities as a whole. Industry Canada managers advised us that they have some oversight mechanisms in place that keep them aware of program performance. Industry Canada has observer status on the CANARIE Board of Directors and other committees and regularly attends these and other meetings. In our opinion, these mechanisms are a useful supplement to regular reporting on performance but should not replace it.

27.74 The agreement with CANARIE makes provision for program evaluations at the end of each phase. Program evaluation is a useful and necessary performance measurement tool but, in our view, it is not a substitute for annual monitoring of performance.

Plans do not include annual performance expectations against which industry Canada could monitor performance of CANARIE activities.

27.75 The results of the recent evaluation support our observation that more frequent performance monitoring by Industry Canada would be in order. The evaluation concludes that CANARIE has met the objectives set for Phase 2. But it also points to a number of concerns that may limit the overall effectiveness of CANARIE's work. The establishment and regular monitoring of performance goals could help Industry Canada and CANARIE to address such problems as they emerge.

Stronger assurance is needed that CANARIE practices meet expectations

27.76 We found that Industry Canada was not doing enough to assure itself that the practices followed by CANARIE in selecting and managing projects meet departmental requirements. At our request, Industry Canada obtained additional information from CANARIE describing the review, approval and selection practices for sub-projects and their management. In our opinion, Industry Canada needs to review this information in light of their expectations and obtain assurance that the procedures are being followed.

27.77 Although the agreement with CANARIE provides for access by the Department to CANARIE documents and premises, officials advised us that to date they have not seen the need to exercise this right. The Department may want to consider the merits of including a clear provision for program performance audit in any future agreement with CANARIE as this can be an important tool to assure Industry Canada that due diligence is exercised by CANARIE.

Industry Canada has satisfactory assurance that the funds are being used for the purposes agreed

27.78 We examined a sample of Industry Canada project files on CANARIE to determine if, once projects had been approved, the Department had

adequate assurance that funds were being spent for the purpose agreed and if there were adequate financial controls in place.

27.79 We found that Industry Canada receives financial claims from CANARIE on a quarterly basis, with proper documentation. In addition, Industry Canada receives a copy of all agreements entered into by CANARIE, and final project reports that describe, among other things, whether the technical goals of the project were met but do not describe the results that were achieved. Departmental officials review these reports.

What is PRECARN?

27.80 PRECARN was established in 1987 as a not-for-profit, industry-led corporation. Managed by a volunteer Board of Directors, PRECARN is a national consortium of Canadian corporations to encourage and support long-term pre-competitive research in advanced robotics and artificial intelligence. Since 1995, PRECARN's scope has broadened to support market-oriented research and development and to promote the understanding, use and exploitation by Canadian industry of intelligent systems and advanced robotics.

27.81 PRECARN is funded under the Strategic Technologies Program (STP) of Industry Canada. The objective of the Program is to enhance the international competitiveness of Canadian industry through the development, acquisition, application and diffusion of strategic technologies in Canada. Support to PRECARN differs from the other types of research and development alliances funded under the STP. PRECARN itself does not perform research, but manages a series of industry-led projects carried out by networks of research teams across the country.

27.82 PRECARN has been supported through non-repayable contributions under the STP since 1989. Under Phase 1, the Treasury Board approved the provision of financial assistance to PRECARN of up to

\$16 million over a six-year period. Phase 2 was approved in late 1994. It comprised an additional \$19.9 million (revised to \$19.4 million) over the five-year period from 1995–96 to 1999–2000.

27.83 The Phase 2 research program involves a total investment by all partners in excess of \$50 million over the period 1995–2000. Industry Canada's contribution of \$19.4 million represents approximately 40 percent of the total funding, with the balance coming from industry, PRECARN itself, the provincial government and other federal institutions. Our audit focussed on Phase 2.

Accountability for performance could be improved

27.84 We reviewed the terms and conditions of the contribution agreement between Industry Canada and PRECARN. We found them to be consistent with the objectives and funding criteria of the Strategic Technologies Program. These terms and conditions included provisions for oversight and reporting.

27.85 However, we found that although the agreement provided for oversight by Industry Canada, in practice some of the provisions were not being followed.

27.86 As required by the agreement, PRECARN submits an annual business plan, setting out clear performance expectations. In its capacity as an official observer to the PRECARN Board of Directors, Industry Canada is in a position to comment on the development of the plan. However, we saw no evidence that Industry Canada undertakes an independent review of the plan to ensure that it is in line with departmental expectations; nor does Industry Canada formally approve the plan, as the agreement requires.

27.87 We also found that the Department does not monitor, in an independent way, the results achieved annually. Industry Canada officials

informed us that they have some mechanisms in place to monitor performance. These include participating in meetings of the PRECARN Board of Directors and other committees in an observer capacity, attending PRECARN conferences and workshops and other meetings, as well as periodic program evaluations at roughly five-year intervals. We acknowledge the value of these mechanisms but maintain that annual independent performance monitoring, as required by the agreement, is essential for effective accountability.

Industry Canada could improve its assurance that funds are being used for the purposes agreed

27.88 The agreement between Industry Canada and PRECARN stipulates that claims for payment should be accompanied by brief quarterly progress reports on each approved project and that claims should be certified by an officer of PRECARN. Our review of Industry Canada files revealed that quarterly reports did not accompany claims for payments in more than two thirds of the cases, although claims were duly certified by a PRECARN officer. We question whether Industry Canada is able to assure itself fully prior to payment of a claim that funds are being used for the purposes agreed. Information on the work completed would be in quarterly reports, which do not routinely accompany the claims. Officials stated that, in their view, certification of the claims by an officer of PRECARN provides adequate assurance that funds are being used for the purposes agreed. However, we maintain that such certification does not remove from Industry Canada the obligation to implement the terms of the agreement.

Greater assurance is needed that PRECARN practices meet expectations

27.89 In grant and contribution programs, due diligence requires that applications for funding be assessed against terms and conditions established

Industry Canada does not monitor, in an independent way, the results achieved annually by PRECARN.

There are significant opportunities to improve the management of these programs and individual contribution agreements.

by the Treasury Board. With indirect program delivery, such as in the case of PRECARN, we would expect Industry Canada to obtain assurance that the processes used to select projects for funding respect those terms and conditions. We acknowledge that Industry Canada's participation in PRECARN management committee and Board meetings as an observer does offer some assurance that PRECARN's decision-making processes represent due diligence. However, assurance would be strengthened by Industry Canada fulfilling its obligations to review and approve the annual business plan, which contains a description of the processes used by PRECARN to ensure due diligence.

27.90 In addition, the agreement with PRECARN stipulates the Minister's right to access PRECARN documents and premises to assess the progress and results of the work. Officials advised us that to date they have not seen a need to exercise this right. In our view, periodic program performance audit is another important tool to assure Industry Canada that due diligence is exercised by PRECARN.

27.91 Industry Canada should:

- obtain assurance that CANARIE and PRECARN exercise due diligence in selecting and managing projects;
- set clear annual performance expectations for its contributions; and
- assess performance annually.

Department's response: CANARIE and PRECARN are innovative approaches created to efficiently and effectively forge private-public sector research and development linkages. In the development of innovative program management techniques, Industry Canada has relied upon a number of mechanisms (i.e. Board participation, meetings with CANARIE/PRECARN management), and various performance indicators to ensure that due diligence was achieving their intended objectives. As "third-party

delivery" management practices continue to be refined in government, more sophisticated performance measurement frameworks, focussing on the core components of performance measurement (i.e. reach, results, resources), have been developed. In this context, the Auditor General's review has been useful and timely given the Department's policy agenda. The Auditor General's comments will be fully considered as performance measurement techniques are implemented in the future management of these and similar programs.

Conclusion

27.92 The purpose of our audit was to determine whether there were opportunities to improve the management of specific programs in Industry Canada and Canadian Heritage. The grant and contribution programs that we audited dealt with economic and social development issues — Ontario Base Closures Assistance Program and the Multiculturalism Program respectively. These programs are good examples of programs delivered by departments directly. We also audited examples of indirect delivery — Industry Canada's contribution agreements with CANARIE and PRECARN — since this approach is becoming increasingly common.

27.93 We concluded that there are significant opportunities to improve the management of these programs and individual contribution agreements.

- Industry Canada needs to apply the terms and conditions approved by the Treasury Board for the Department's grants and contributions. Good documentation is a necessary part of proper justification for the decision to fund projects.

- Canadian Heritage needs to clarify the objectives of the Multiculturalism Program by defining clear, attainable goals and expected annual results. It also needs to ensure due diligence is exercised

in the approval of grants and contributions under the Program.

- In indirect delivery arrangements, it is important that Industry Canada have assurance that the organizations with

which it has contribution agreements exercise due diligence. The Department also needs to set clear annual performance expectations for these arrangements and assess performance annually.



About the Audit

Objective

Our audit objective was to determine whether there are significant opportunities to improve the management of specific programs in Industry Canada and the Department of Canadian Heritage. We do not provide an opinion on all aspects of the management of these programs.

Criteria

We examined whether management assured itself that:

- the projects represented value for money to both the applicant and the program; and
- the funds were used for the purposes agreed.

While we focussed on these two criteria in particular, we also considered other qualities from our performance management framework for grant and contribution programs where appropriate.

Scope

We examined grant and contribution programs delivered directly by Industry Canada and Canadian Heritage. We also examined indirect delivery arrangements in Industry Canada. Direct delivery refers to grants and contributions managed entirely by a department. Indirect delivery refers to arrangements where a department contributes funds to an organization outside the government that, in turn, distributes funding to the intended recipients.

Direct Delivery

- Industry Canada: Contributions under Ontario Base Closure Adjustment Program
- Canadian Heritage: Grants and Contributions under the Multiculturalism Program

Indirect Delivery

- Industry Canada: Contributions to Canadian Network for the Advancement of Research, Industry and Education (CANARIE), and to Precompetitive Advanced Research Network (PRECARN)

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Appendix A

Planned Expenditures on Grants by Departments and Agencies, 1998–99*

Department/Agency	\$ Millions	Statutory (percentage)	Purpose
Human Resources Development	23,155.40	99.2%	Old age security, guaranteed income supplements, scholarships, labour benefits and income support, promoting integration of disabled persons, fishers and plant workers affected by the East Coast groundfish crisis
Veterans Affairs	1,229.00	0.02%	Compensation for death and disability, War Veterans Allowances
Indian Affairs and Northern Development	882.20	14.3%	Implementation of land claim settlements; administration of bands, councils, educational and cultural activities; research in the North; Healing Strategy
Natural Sciences and Engineering Research Council	475.80	—	Scholarships and grants in aid of university research
Canadian International Development Agency	351.20	—	Development assistance, programs against hunger and malnutrition, humanitarian assistance, disaster preparedness
Medical Research Council	257.70	—	Scholarships and grants in aid of university research
Finance	150.20	—	Commitments under multilateral debt reduction agreements, equalization payments to provinces
Citizenship and Immigration	148.90	—	Integration of newcomers to Canada
Social Sciences and Humanities Research Council	92.50	—	Scholarships and grants in aid of university research
Agriculture and Agri-Food (portfolio)	74.80	0.3%	Economic development and innovation
Department of Canadian Heritage (portfolio)	72.10	0.9%	Cultural development, Canadian identity
Justice (portfolio)	62.30	75.3%	Annuities under the <i>Judges Act</i> , Safer Communities Initiative
Health	58.60	—	Support for programs and project on health, community health promotion, training and skill development, Canadian Blood Services, Canadian Strategy on HIV/AIDS, Canadian Breast Cancer Research Initiative
National Revenue	44.00	100.0%	Children's special allowance payments
Solicitor General	42.30	93.0%	Pensions and benefits to RCMP members; advice to Solicitor General
Foreign Affairs and International Trade	23.70	1.1%	Public diplomacy, public and cultural relations, marketing abroad
Transport	22.50	—	Policy development initiatives
Privy Council (portfolio)	16.00	—	Preparation and distribution of documents and reports by the Institute of Intergovernmental Affairs, Queen's University for the Cabinet and Cabinet committees; Millennium Bureau of Canada
National Research Council of Canada	5.20	—	Support for research and industrial innovation
Atlantic Canada Opportunities Agency	5.00	—	Economic co-operation and development in Atlantic Canada
Western Economic Diversification	5.00	—	Facilitating access to capital and business information, developing and delivering targeted business services in Western Canada
National Defence	4.00	4.4%	Activities to assist in achieving defence objectives, corporate management and support services
Environment	3.30	—	Universities, research and related activities
Canadian Space Agency	1.10	—	University research, scholarships and fellowships
Industry Canada	0.70	—	Canada Scholarships Program
Natural Resources	0.50	—	Research and development, activities contributing to departmental objectives
Economic Development Agency of Canada for the Regions of Quebec	0.40	—	Support for innovation, market development, entrepreneurship in Quebec
Treasury Board	0.30	24.7%	<i>Public Service Pension Adjustment Act</i> , Workers' Compensation
Fisheries and Oceans	0.20	—	Research and development activities
Others	0.50	97.6%	
Total	27,185.40		

*For more details, refer to Performance Reports of each department and agency.

Source: 1998–99 Estimates, Part II – The Main Estimates and Supplementary Estimates (A).

Grants and Contributions: Selected Programs in Industry Canada and Department of Canadian Heritage

Appendix B

Planned Expenditures on Contributions by Departments and Agencies, 1998–99*

Department/Agency	\$ Millions	Statutory (percentage)	Purpose
Indian Affairs and Northern Development	3,474.30	—	Economic development, education and social development, health care, research and training, employment initiatives
Human Resources Development	1,686.40	47.8%	Student loans, training and/or work experience, child care initiatives, retraining, development of learning and training technologies, adults with disabilities
Canadian International Development Agency	989.80	—	Development assistance, payments for loan agreements
Agriculture and Agri-Food Canada (portfolio)	967.60	72.3%	Economic development, market access and development, innovation, ice storm assistance
Health	730.20	—	Aboriginal health services, facilities, education; health research, alcohol and drug treatment, tobacco control enforcement, health information systems, Canadian Blood Agency, Canadian Strategy HIV/AIDS
Industry Canada	547.50	13.7%	Industry sector development including technological innovation, research and development, job creation
Transport	544.00	40.3%	Subsidy programs for divestiture of and operation of ports, airports, highways and bridges; transition payments to NAV CANADA; research and development, monitoring, testing, inspection, safety and security programs
Department of Canadian Heritage (portfolio)	466.20	—	Promoting official languages, broadcasting distribution, Canadian identity, developing athletes, national parks
Economic Development Agency of Canada for the Regions of Quebec	371.80	24.9%	Innovation, market development, entrepreneurship, economic recovery in Quebec
National Defence	367.70	4.9%	Support to NATO; pension and retirement benefits; support to the UN training assistance programs and peacekeeping operations; civil emergency preparedness, natural disasters
Justice (portfolio)	288.00	—	Legal aid systems, cost-sharing of juvenile justice services, firearms program, supporting funds related to Justice, Safer Communities Initiative
Western Economic Diversification	270.50	16.3%	Business development, research and development, specialized loans and investment funds, infrastructure works in Western Canada
Foreign Affairs and International Trade	264.90	—	International security and co-operation, international business development, export market development
Atlantic Canada Opportunities Agency	264.30	3.9%	Regional development programs and activities
Finance	171.40	—	Commitments under multilateral debt reduction agreements in Atlantic Canada
Citizenship and Immigration	166.20	—	Integration of newcomers, humanitarian aid
Veterans Affairs	158.10	—	Extended health care costs not covered by provincial health programs
National Research Council of Canada	143.80	—	Support for research, technology and innovation; developing, adapting and exploiting technology
National Revenue	92.80	—	Joint administration costs of federal and provincial sales tax
Natural Resources	75.70	17.0%	Research and development; supporting management and sustainable development; ensuring federal policies, Climate Change Action Fund and regulations enhance the contribution of natural resources to Canada's economy while protecting the environment
Solicitor General	52.20	—	Policing for First Nations and Inuit communities
Treasury Board	44.20	—	Youth Internship Program
Fisheries and Oceans	41.60	0.5%	Increasing Native participation in commercial fisheries, benefits relating to moratorium on northern cod fishery
Environment	36.90	—	Understanding the environment and our environmental responsibilities and taking action to protect, conserve and adapt Climate Change Action Fund
Privy Council (portfolio)	26.10	—	Millennium Bureau of Canada
Canadian Space Agency	21.90	—	Ensuring Canadian leadership in emerging international Earth observation markets, and competitiveness through technology transfer and diffusion
Others	0.90	—	
Total	12,265.00		

*For more details, refer to Performance Reports of each department and agency.

Source: 1998–99 Estimates, Part II – The Main Estimates and Supplementary Estimates (A).

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December 1998

**Report of the
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of Canada
to the House of Commons**

Chapter 28
Follow-up of Recommendations in
Previous Reports

Chapter 29
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Appendices

December 1998

This December 1998 Report comprises 11 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the April, September and December 1998 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

Chapter 28

**Follow-up of Recommendations
in Previous Reports**

The follow-up work was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Follow-up of Recommendations in Previous Reports

Main Points

28.1 The amount of progress toward meeting the recommendations of previous audits covers a broad spectrum. In some cases, all significant recommendations have been addressed. In other cases, there is little or no evidence of corrective action being taken. Most cases fall somewhere between these extremes.

28.2 The following significant areas of concern remain:

- Health Canada is not in a position to effectively co-ordinate and respond to a major nuclear accident affecting Canada.
- It is not clear whether the Code of Environmental Stewardship is still in place for those agencies not required to produce a sustainable development strategy and there is also a need to involve Crown corporations in the government's greening efforts.
- We observed that adequate strategic reconnaissance is still not being conducted prior to deployment of all peacekeeping missions.
- Awareness of the potential risks to health, safety and the environment from federal contaminated sites, and the government's lack of a comprehensive plan to manage its risks and associated costs is still an issue.
- Information systems under development remain a concern due to their significance, in terms of the size of the investments and their impact on operations, and continuing delays in the planned implementation dates for certain systems.

28.3 There are also successes to report:

- Since our audit in 1996, materiel management has decreased reported inventories in four departments by more than \$480 million.
- Progress has been made in improving the quality of internal audit management.
- Revenue Canada has taken steps to ensure that excise taxes and duties on selected commodities are correctly assessed, collected and reported.
- Progress has been made in strengthening the control and accountability of the Canadian intelligence community.

28.4 We are encouraged by the amount of progress reported, and urge departments and agencies to continue their efforts in addressing our concerns until all significant matters have been resolved through corrective action.

Introduction

28.5 At a suitable time after each of our audits, we review the actions taken by departments in response to observations and recommendations made in our reports and by parliamentary committees.

28.6 The purpose of our follow-up work is to provide Parliament with a progress report on action taken by departments in response to our previous recommendations. We continue to monitor these issues until corrective action is implemented or until recent events make further action unnecessary.

28.7 Our follow-up work provides a moderate level of assurance that departments have acted on our recommendations. In most cases, it is performed through a review of documentation, interviews with departmental officials, and a review of any other evidence that allows us to draw a conclusion on the plausibility of the information presented.

28.8 We normally report on the status of progress made two years after we publish the original chapter, but this may vary depending on the scope or

complexity of changes undertaken by departments. Some follow-up activity is reported as separate chapters, or reported with audits of similar issues. Exhibit 28.1 provides a list of audits due for follow-up but not included in this chapter.

28.9 Summarizing all follow-up work reported in 1998, approximately 49 percent of our previous recommendations have been fully implemented or are proceeding at a satisfactory rate. About 44 percent of our previous recommendations require additional effort before corrective action can be considered complete. The remainder are cases where the department did not agree with our recommendations, or subsequent events have rendered the recommendation no longer applicable.

28.10 This chapter reports on the follow-up of 21 audits conducted between 1992 and 1996. The results are extremely varied. They range from all recommendations having been suitably addressed to cases where action on all recommendations has been insufficient. Results in the majority of the individual reports lie somewhere between these two extremes.

Follow-up of Recommendations in Previous Reports

Exhibit 28.1

Other Chapters Due for Follow-up

Year and Chapter	Chapter Title	Original Responsible Auditor	Follow-up Status
1993			
22	Department of Transport – Airport Transfers	Hugh McRoberts	Deferred from 1995 as no further transfers had been made to airport authorities. To be included in a new chapter, tentatively planned to report in 2000.
1994			
9	Science and Technology – Overall Management of Science and Technology Activities	Richard Flageole	These audits are being followed up in a phased approach: <ul style="list-style-type: none"> Government-wide issues related to the management of research activities and scientific personnel were followed up in Chapter 15 of our 1996 Report. Further progress is found in Chapter 22 of this report. Issues at the departmental level will be the subject of further study, tentatively planned to report in 1999, and an audit planned to report in 2000.
10	Science and Technology – Management of Departmental Science and Technology Activities	Richard Flageole	
11	Science and Technology – The Management of Scientific Personnel in Federal Research Establishments	Jacques Goyer	<ul style="list-style-type: none"> Our follow-up work dealing with the “Framework for the Human Resource Management of the Federal Scientific and Technical Community” is planned to report in 1999.
12	Aspects of Federal Real Property Management	Reno Cyr	Deferred. Government downsizing has resulted in departments being restructured and will result in a shift in focus for the follow-up. Tentatively planned to be combined with an audit of this area planned to report in 1999. See 1994 Chapter 34 below.
18	Correctional Service Canada – Supervision of Released Offenders	David Brittan	Deferred. Planned to be combined with a follow-up of Chapters 10 and 30 of the 1996 Report, and included in a separate chapter planned to report in 1999.
34	Public Works and Government Services Canada – Management and Operation of Crown-owned Office Buildings	Michael Weir	Deferred. Government downsizing has resulted in departments being restructured and will result in a shift in focus for the follow-up. See 1994 Chapter 12 above. Tentatively planned to be combined with an audit of this area planned to report in 1999.
1995			
5	Office of the Superintendent of Financial Institutions – Deposit-Taking Institutions Sector	Beant Barewal	Deferred. Tentatively planned to be combined with a follow-up of Chapter 30 of the 1997 Report planned to report in 2000.
9	Information for Parliament – Deficits and Debt: Understanding the Choices	Jeff Greenberg	Reported in Chapter 6 of the April 1998 Report.
10	Crown Corporations – Fulfilling Responsibilities for Governance	Grant Wilson	Portions of the chapter are being followed up in a phased approach: <ul style="list-style-type: none"> Performance measurement was followed up in Chapter 22 of the December 1997 Report. Further follow-up on special examinations is planned to report in 2000.
13	Canadian International Development Agency – Phased Follow-up: Geographic Programs – Phase I	Vinod Sahgal	This chapter was the first segment of a phased follow-up to Chapter 12 of the 1993 Report. Phase II was reported in Chapter 29 of the 1996 Report. The final phase is reported in Chapter 21 of this report.
24	Revolving Funds in the Parliamentary System – Financial Management, Accountability and Audit	Michael Weir	Deferred. Tentatively planned to report in 1999.

Exhibit 28.1 (cont'd)

Year and Chapter	Chapter Title	Original Responsible Auditor	Follow-up Status
1996			
3	Evaluation in the Federal Government	Stan Divorski	Deferred. Tentatively planned to be combined with an audit of performance reporting to Parliament planned to report in 2000.
5	Reform of Classification and Job Evaluation in the Public Service	Jacques Goyer	Deferred. Tentatively planned to report in 2000.
8	CSIS – National Headquarters Building Project	Reno Cyr	Deferred. Tentatively planned to report in 1999.
10	Correctional Service Canada – Rehabilitation Programs for Offenders	David Brittain	Deferred. Planned to be combined with a follow-up of Chapter 18 of the 1994 Report and Chapter 30 of the 1996 Report, and included in a separate chapter planned to report in 1999.
13	Study of Accountability Practices from the Perspective of First Nations	Ronnie Campbell	There will be no follow-up of Chapter 13. It was a study and contained no recommendations.
14	Service Quality	Theresa Duk	Deferred. Tentatively planned to be combined with an audit in this area planned to report in 1999.
15	Federal Science and Technology Activities – Follow-up	Richard Flageole and Jacques Goyer	There will be no separate follow-up of Chapter 15. It was a follow-up of the government-wide issues raised in Chapters 9 and 11 of the 1994 Report. Further progress is found in Chapter 22 of this report.
16	Treasury Board Secretariat – Renewing Government Services Using Information Technology	Nancy Cheng	Deferred. Tentatively planned to report in 1999.
17	Human Resources Development Canada – Canada Pension Plan: Disability	Louis Lalonde	Deferred. Tentatively planned to report in 1999.
19	Revenue Canada – Child Tax Benefit and Goods and Service Tax Credit Programs	Basia Ruta	Deferred. Tentatively planned to be combined with an audit in this area planned to report in 2001.
21	Federal Debt Management	Brian Pearce	There will be no follow-up of Chapter 21. It was a study providing information to Parliament on management of debt and contained no recommendations. This will be subject of an audit planned to report in 1999.
25	Canada's Export Promotion Activities – Foreign Affairs and International Trade and Industry Canada.	Lew Auerbach	Deferred. Tentatively planned to report in 1999.
26	Canada Infrastructure Works Program: Lessons Learned	Henno Moenting	Deferred. Tentatively planned to be combined with an audit in this area planned to report in 1999.
29	Canadian International Development Agency: Phased follow-up: Geographic Programs – Phase II	Vinod Sahgal	This chapter was the second segment of a phased follow-up to Chapter 12 of the 1993 Report. Phase I was reported in Chapter 13 of the 1995 Report. The final phase is reported in Chapter 21 of this report.
30	Correctional Service Canada – Reintegration of Offenders	David Brittain	Deferred. Planned to be combined with a follow-up of Chapter 18 of the 1994 Report and Chapter 10 of the 1996 Report, and included in a separate chapter planned to report in 1999.
33	Indian and Northern Affairs Canada – Funding Arrangements for First Nations	Grant Wilson	Deferred. Tentatively planned to report in 1999.
34	National Defence – Support Productivity	Peter Kasurak	Deferred. The original chapter looked at the Department of National Defence mid-way through its renewal process. The follow-up will be conducted after the renewal process is complete and is tentatively planned to report in 2000.

Emergency Preparedness in the Federal Government — Nuclear Emergencies — 1992, Chapter 24

Assistant Auditor General: David Rattray

Principal: Alan Gilmore

Background

28.11 We reported to Parliament on federal government emergency preparedness in 1987, 1989 and 1992 for catastrophic earthquakes, chemical and oil spills and nuclear accidents. In 1995 and 1997, we reported that major improvements were still needed in preparing for major earthquakes and chemical and oil spills.

28.12 This report focusses on emergency preparedness for major nuclear accidents. Our 1987 and 1992 reports noted that major improvements were needed in federal preparedness and response planning for nuclear emergencies.

28.13 Municipal, provincial and federal governments share responsibility for emergency planning. Primary responsibility rests with the provinces. If the nuclear emergency is beyond the municipal and provincial capacity, provinces can request federal involvement. However, the co-operation of all levels of government is required to ensure that emergency plans, policies and procedures will work when needed.

28.14 In 1984, Health Canada was designated the lead federal government department for planning and responding to nuclear emergencies. This designation was reconfirmed in 1994. The first version of the Federal Nuclear Emergency Response Plan was issued in 1984, and revised in 1991. In October 1993, Health Canada initiated a comprehensive review of the Plan, which was completed in March 1994. Subsequently, the Department initiated a multi-year project to revise the Plan, and in December 1997 an interim Plan was issued.

Most of our concerns about preparedness for nuclear emergencies have not been adequately addressed.

Municipal, provincial and federal governments share responsibility for emergency planning.

28.15 The Plan addresses nuclear emergencies resulting from serious accidents involving nuclear power generating stations, nuclear-powered vessels and nuclear weapons, and the re-entry of nuclear-powered satellites. Threats also can arise from serious accidents in other countries.

28.16 The Atomic Energy Control Board (AECB), Canada's nuclear regulatory agency, is responsible under the *Atomic Energy Control Act* for inspecting and regulating nuclear materials throughout their life cycle. Its responsibilities include regulating the nuclear reactors, the use of radioactive materials in industry and institutions, and the transportation and disposal of nuclear radioactive wastes.

Scope

28.17 We reviewed the progress made since 1992 in addressing the recommended improvements in federal government preparedness for nuclear emergencies.

Conclusion

28.18 While some progress has been made, most of the concerns about federal government preparedness for nuclear emergencies reported in our 1992 chapter have not yet been adequately addressed. We are concerned that Health Canada is not in a position to effectively co-ordinate and respond to a major nuclear accident affecting Canada.

28.19 Although Health Canada has issued an interim response plan called the Federal Nuclear Emergency Plan, other federal departments and agencies and the provinces have not yet approved it. Neither the new Plan nor its predecessor

has been tested in an integrated interdepartmental, provincial and municipal exercise. CANATEX 3, a "desk top" simulation exercise of the Plan, was scheduled for April 1998 but has been postponed to April 1999.

28.20 Three provinces have established radiation exposure standards for initiating protective action as a result of a nuclear emergency; however, the standards differ among the provinces. We believe that national standards are needed to avoid delays and confusion in responding to radiation exposure.

28.21 A July 1997 report by Ontario Hydro concluded that all its nuclear power generating stations were performing substantially below industry standards, but producing minimally acceptable results. Over the past decade, the Atomic Energy Control Board has regularly advised Ontario Hydro that it needed to take substantial corrective action.

28.22 The AECB has concluded that Ontario Hydro nuclear reactors can continue to operate safely in the short term. However, the Board cautioned that "defence-in-depth" for safety has been eroded at Ontario Hydro nuclear generating stations. AECB also advised us that the nuclear stations in Quebec and particularly New Brunswick were experiencing problems similar to those in Ontario, but that these are more easily remedied.

Observations

After six years the Federal Nuclear Emergency Plan is still incomplete

28.23 Since our 1992 audit, Health Canada has conducted a review of the Federal Nuclear Emergency Response Plan. In December 1997, it issued an interim plan, now renamed the Federal Nuclear Emergency Plan.

28.24 Detailed planning has yet to be completed. Those matters that still need to

be addressed include preparing an implementation plan, identifying interfaces with all provinces, developing communication protocols for departments and provinces, and establishing technical co-ordination plans for plume tracking, field surveys, dose assessment and food control. Training requirements and any formal arrangements that may be needed among federal departments and agencies also need to be addressed.

28.25 Thirteen federal departments and agencies that have major responsibilities for responding to nuclear accidents have been consulted, but they have not yet indicated their approval of the Plan. Health Canada has received departmental support plans from only two of these departments, and it has not completed its own departmental support plan. Without departmental plans, it is difficult to establish standard operating procedures that identify the required tasks, when these tasks should be performed, and the staff who should perform them.

28.26 Emergency Preparedness Canada established the Emergency Preparedness Advisory Committee. It is composed of assistant deputy ministers of departments and agencies that would have significant roles and responsibilities in responding to emergencies of all types, including nuclear emergencies. The interim Federal Nuclear Emergency Plan identifies an Executive Group composed of members of the Advisory Committee. The Group's responsibilities include decision making, implementation of the Plan, briefings to Cabinet and conflict resolution.

28.27 We are concerned that decision making and implementation of the Plan may be hampered because most of the assistant deputy ministers on the Advisory Committee have not attended meetings of the Committee during the last four years, and none have participated in emergency preparedness training sessions specifically designed to prepare them for their roles.

Decision making and implementation of the Federal Nuclear Emergency Plan may be hampered.

The lack of common standards may result in unnecessary delays, concerns and confusion.

The interim Federal Nuclear Emergency Plan still needs to be tested

28.28 The Federal Nuclear Emergency Plan has not been tested in integrated interdepartmental, provincial and municipal exercises. The Plan was to be tested during a “desk-top” exercise called CANATEX 3 in April 1998. However, Emergency Preparedness Canada told us that the exercise was postponed to April 1999 at the request of the Province of Ontario. Such a test is needed to determine the weaknesses in the emergency response capabilities and to allow for corrective actions to be taken.

There are no national radiation exposure standards for initiating protective measures

28.29 Our 1992 Report pointed out that the Federal Nuclear Emergency Response Plan did not provide guidance on the specific levels of radiation at which action should be initiated to protect against radiation exposure from contaminated air, water, soil and food as a result of a nuclear emergency.

28.30 The interim Plan includes the provincial guidelines on specific levels of radiation at which action should be initiated to protect against radiation exposure. The three provinces with nuclear power plants — Ontario, Quebec and New Brunswick — have adopted different levels of radiation exposure as the threshold for initiating protective measures. Such measures include advising people to stay indoors, evacuation, distributing stable iodine, and temporary and permanent relocation. Other jurisdictions have not established standards.

28.31 The lack of common standards may result in unnecessary delays, concerns and confusion because citizens of different provinces confronted with similar threats may receive different advice and direction. We note that the

United States and the United Kingdom have adopted national radiation exposure standards for initiating protective action. We believe national standards of radiation exposure for initiating protective action are required.

28.32 Health Canada told us that it is presently working on a national safety standard for food and water that are contaminated as a result of a nuclear emergency, and that it intends to develop a national standard for radiation exposure for the public.

The interim Plan recognizes that the provinces have primary responsibility and will seek federal assistance as needed

28.33 The interim Plan recognizes that the provinces have primary responsibility for health and safety and for addressing nuclear emergencies that affect their populations as a result of accidents in Canada, the United States and elsewhere. The interim Plan contains five interim provincial annexes prepared by Health Canada and the emergency measures organizations of Ontario, Quebec, New Brunswick, Nova Scotia and British Columbia. The interim provincial annexes briefly describe on a summary level the concept of operations, links between federal and provincial organizations, and the roles of federal and provincial governments. Annexes for the remaining provinces and territories have not been developed.

28.34 Health Canada acknowledges that there are significant differences among the provinces in resources, capabilities and needs. In our 1992 Report, we recommended that the Federal Nuclear Emergency Response Plan should, to the extent possible, indicate the support and resources that provinces would need and where such resources might be obtained. Health Canada still has no information on the needs or the support resources required by the provinces.

Major improvements in nuclear power station operations are needed

28.35 In July 1997, Ontario Hydro reported the findings of its Independent Integrated Performance Assessment and Safety System Functional Inspections of its nuclear power generating stations. The report assessed all stations in terms of nuclear safety, production, environmental matters and cost competitiveness. It ranked all stations as “minimally acceptable”—that is, “performance is substantially below industry standards but produces minimally acceptable results.”

28.36 Emergency preparedness includes such matters as processes to control fires, to respond to radiological emergencies, and to maintain emergency preparedness plans. Ontario Hydro’s report ranked all stations as “below standard” with respect to emergency preparedness — that is, “performance is below industry standards and generally produces the desired results.”

28.37 Since 1989, the AECB has regularly advised Ontario Hydro that substantial corrective actions were needed in the operation of its nuclear power generating stations. The AECB’s follow-up report on the July 1997 Ontario Hydro report concluded that although “defence-in-depth” for safety has been eroded at Ontario Hydro nuclear generating stations, the reactors could continue to operate safely in the short term.

28.38 The AECB report also noted that significant improvement is necessary in Ontario Hydro’s operations to improve safety margins and to prevent further deterioration in performance. The AECB advised us that the status of nuclear stations in Quebec and particularly New Brunswick is similar to that of Ontario Hydro; however, the problems at the Quebec and New Brunswick stations are more easily addressed because these are smaller nuclear facilities.

The AECB concluded that “defence-in-depth” for safety has been eroded at Ontario Hydro nuclear generating stations.

Health Canada — Management of the Change Initiative at Health Protection Branch — 1995, Chapter 4

Assistant Auditor General: *Maria Barrados*

Director: *Ronnie Campbell*

Background

28.39 The Health Protection Branch of Health Canada is mandated to carry out programs to assess and manage the public health risks faced by Canadians. In 1995 we reported on progress made by the Branch on a program re-engineering initiative it undertook starting in 1993. The Branch began its self-initiated change process to resolve the dilemma of managing current and new public health risks in the face of budgetary pressures, as well as to correct known problems in the drugs and medical devices programs. We undertook this audit to assess the early successes of the change initiative.

Scope

28.40 Our follow-up consisted of reviewing status reports prepared by the Branch on the progress it had made in responding to our observations and recommendations. We also interviewed selected Branch officials and reviewed supporting documentation.

Conclusion

28.41 The Branch has taken some action on all of our observations and recommendations. However, in most areas, additional work remains to be done to fully address our concerns. Further, it is still early to assess the impact of some initiatives that have only recently been implemented or are in the process of being implemented.

28.42 The pressure for change due to reduced budgets and growing public expectations concerning the management of health risks continues for the Branch. Past renewal initiatives have been succeeded by a new process of renewal,

In most areas, additional work remains to be done by the Health Protection Branch to fully address our concerns.

Health Protection Branch Transition.

Some projects under way at the time of our 1995 audit have been completed. Other projects remain outstanding and have been incorporated into the new process of renewal.

28.43 Action taken by the Branch to improve information on the effectiveness of its programs has yet to be translated into improved performance information. The Branch needs to complete its revised risk management framework, for use in better allocating resources and setting priorities. In some areas where revenue generation opportunities were identified, revenue is not yet being collected. Changes have been made to address known problems in the drugs program, such as enhancing the submission tracking system. The Branch recognizes that further changes are required in streamlining the assessment process. Regulatory changes to improve the management of risks associated with drugs have not yet been fully implemented.

Observations

Overall momentum of change at the Branch

28.44 Audit observations in 1995. Our audit noted that by 1994 much of the early momentum of the re-engineering initiative had begun to dissipate. Other events, such as the government-wide program review, diverted attention and energy from the process.

28.45 Follow-up observations. Since our last audit, there have been organizational changes in the Branch, such as the amalgamation of the drugs program and the medical devices program to form the Therapeutic Products

Program. The Branch has also begun a new process of renewal, Health Protection Branch Transition. Work is focussing on five areas — legislative renewal, the surveillance core, the science core, the risk management framework, and program development. The Branch initiated this three-year process in 1997 to respond to continuing challenges, such as resource constraints, and to new challenges, such as the pressures of increasing globalization on public health. The Branch expects the Transition initiative to re-create the early momentum of the re-engineering initiative and to deal with the many challenges it continues to face.

28.46 In addition, the Department established a Science Advisory Board in December 1997 to provide independent advice to the Minister of Health on how best to position the scientific, technical and policy aspects of Branch programs, now and in the future. Its responsibilities include advising on ongoing measures required to ensure that the Branch science retains the confidence of the public, and advising on the scientific and technical adequacy of Branch programs, procedures, methodologies, protocols and tests.

Observations on individual projects

28.47 Many of the projects under way at the time of our 1995 audit have been completed. Others have yet to be implemented or have been incorporated into the new process of renewal.

Information on the effectiveness of Branch programs

28.48 Audit observations in 1995. We found that the absence of information on the effectiveness of Branch activities provided a weak foundation for efforts to assess public health risks and to rationalize budget allocations. We recommended that the Branch improve the information available on the effectiveness of its programs.

28.49 Follow-up observations. Our follow-up review found limited progress

made by the Branch in producing improved information on the effectiveness of its programs. The Branch initiated a project in December 1995 to develop an outcomes-based program performance framework that would allow comparison of actual results with established objectives for a program. The framework was applied in pilot tests in individual directorates within the Branch and received management endorsement in July 1997. At the time, the Branch stated that further work was required to complete the framework, including identifying data that could be collected, analyzed, and used to produce key information about the program being examined.

28.50 At the time of our follow-up, the Branch had not yet implemented the framework throughout the Branch. As a result, although individual directorates have started preliminary work to collect better effectiveness information, to date the framework has not resulted in improved information on the effectiveness of Branch programs.

Risk management and priority setting

28.51 Audit observations in 1995. We recommended that the Branch improve its approach to the management of public health risks for use in allocating resources and setting priorities. The Branch agreed, stating that this was a key component of its plans to strengthen its evidence-based approach to priority setting and risk management.

28.52 Follow-up observations. Our follow-up review confirmed that while the Branch has done work on a revised risk management framework, it is not yet complete. A draft framework was presented to the Branch's senior management in December 1997. Working groups were then established to develop guidelines to implement the framework. Implementation will begin in 1999, with full implementation sometime in 2000. In addition, while a general framework for priority setting and resource allocation has been completed and directorates within

The Health Protection Branch needs to complete its revised risk management framework for use in better allocating resources and setting priorities.

the Branch have undertaken work to determine their individual priorities, this work has not been consolidated at the Branch level.

Revenue generation

28.53 Audit observations in 1995. In our 1995 audit, we observed that the Branch had developed a revenue plan identifying 18 activities where user fees could be implemented between 1994–95 and 1997–98. The plan estimated potential gross revenues of \$90 million over this period, with an initial outlay of \$35 million.

28.54 Follow-up observations. The Branch is collecting revenues in 13 of the 18 activities it had identified. Of the remaining five activities, two were subsequently deemed unsuitable for revenue generation, while the remaining three are expected to start generating revenues by 1999–2000. The Branch collected \$86.5 million in revenues between 1994–95 and 1997–98. Revenues from one activity — drug evaluations and submissions — were higher than expected due to a change in the fee structure and a greater number of submissions than anticipated. This has increased total revenues to a level near the original estimate.

Drug approval

28.55 Audit observations in 1995. Our audit noted that in 1993 the Branch had initiated a strategy with specific projects designed to fix all problems known at that time in the drug approval process. All projects were scheduled to be completed by August 1995. Examples of projects discussed in the 1995 chapter that were not complete at that time were the need to streamline the assessment processes for certain categories of drug products, including high-risk products, the implementation of improvements to the emergency drug release program, and the reduction in the backlog of drug submissions. In particular, the Branch

stated that eliminating the backlog would become the priority of the renewal program during 1995.

28.56 Follow-up observations. Our follow-up observations focus on the examples cited in our 1995 audit. Our review confirmed that the Branch has taken steps to streamline the assessment process for drug products. It enhanced its electronic submission tracking system and developed electronic templates for filing comprehensive summaries of submission data. As well, the Branch revised a number of its policies to improve the assessment process. For example, it updated its management of drug submissions policy in 1997 to outline changes in the way it intended to manage information on drug submissions forwarded by drug manufacturers. The Branch told us that it was currently examining the process for reviewing drug safety, efficacy and quality in order to ensure that the assessment process continues contributing to improved performance.

28.57 The Branch has taken steps to streamline the assessment process for drug products; however, several regulatory changes, which the Branch states will improve the management of risks, have not yet been fully implemented. These include changes to the drug product licensing framework.

28.58 The Branch has not yet finalized changes to improve the process it uses to release drugs on an emergency basis. In September 1996, the Branch advised the Public Accounts Committee that it had proposed changes to streamline the process and enhance the compassionate access component of the program, to be implemented late in 1996. Although some initial changes have been made, such as issuing a new policy, full implementation is on hold pending finalization of regulatory changes, anticipated during 1998–99.

28.59 Our review of actions taken to reduce the drug submission backlog found that the backlog remains a concern. In March 1996, the Department updated performance standards for drug submission review, and the Branch now issues a report outlining its performance in reviewing drug submissions. However, between December 1995 and December 1997, while the median approval time for new drug and abbreviated new drug submissions had decreased from 23.2 months to 19.3 months, the backlog had increased by 24 percent. The Branch has indicated that increases in other types of submissions have required significant resources. It also recognizes, however, that the increase in the backlog must be addressed, and it is investigating the causes of the increase.

Medical device approval

28.60 Audit observations in 1995. We observed that program weaknesses relating to medical devices were known, but many would not be dealt with until a proposed regulatory package comprising changes in 16 different areas was implemented. At the time, the Branch expected the new regulations to be implemented by 1997.

28.61 Follow-up observations. Our follow-up review found that while implementation has been slower than expected, new regulations took effect in July 1998. The regulations address the majority of the 16 areas, including enhanced pre-market scrutiny, product and establishment licensing, a risk-based classification system, phased introduction of a quality systems approach, and mandatory reporting of problems with devices. The regulations contain several transitional provisions, meaning full implementation has not yet occurred.

Public Works and Government Services Canada — Northumberland Strait Crossing Project — 1995, Chapter 15

*Assistant Auditor General: Shahid Minto
Principal: Hugh McRoberts*

Background

28.62 Our 1995 audit of the Northumberland Strait Crossing project (now the Confederation Bridge) focussed primarily on procurement, financial analysis, taxation, environment and reporting to Parliament. Our intention was to provide an early warning to Parliament about any significant potential problems and to encourage any improvements that could be made. The audit covered the planning and implementation phases of the project up to July 1995.

The government has been managing environmental aspects of the Northumberland Strait Crossing project appropriately.

28.63 We drew several conclusions, one of which was that the project's environmental aspects were being handled within the intent of the Environmental Assessment and Review Process. Overall, we made no recommendations, but stated that we would monitor the project, specifically with respect to environmental issues and the overall results of the bridge construction.

28.64 The Confederation Bridge was officially opened, on schedule, on 31 May 1997.

Scope

28.65 We limited our follow-up to environmental matters and to tolls. For the former, we wanted to assess whether the government was continuing to manage the project's environmental aspects appropriately. Our follow-up on tolls looked at whether the government, in approving the toll schedule, had complied with toll provisions set out in the original agreements signed in 1993 between the government and the developer, Strait Crossing Development Inc. (SCDI).

28.66 We reviewed supporting documentation, interviewed government and SCDI officials, and visited the completed bridge. We did not audit SCDI and express no opinion on its actions.

Conclusion

28.67 Based on our review, we conclude that since the time of our original audit, the government has been managing the project's environmental aspects appropriately and that the toll schedule approved by the government was in accordance with the Bridge Operating Agreement.

Observations

Environment

28.68 As a requirement of this project, the developer prepared an Environmental Management Plan (EMP) for the 35-year operating period. The overall Plan is a dynamic, life-of-project document that includes environmental protection and components for monitoring environmental effects. The EMP incorporates the Environmental Protection Plan, which includes ongoing activities, and the Environmental Effects Monitoring Program, which tests predictions of impact and effects of mitigation on ecosystems.

28.69 The Department's Environmental Services Unit (acting as a service provider to the project) has conducted three compliance audits of ongoing operations since the start of construction. The most recent was conducted in the summer of 1996 and concluded that there were no exceptions to compliance with federal, provincial and municipal regulations and guidelines. A fourth compliance audit was

scheduled for the summer of 1998 and will involve the operation phase. The audits were conducted by experienced personnel who used criteria developed through extensive environmental studies and consultations, and reviewed relevant regulatory requirements. We noted that the audit criteria make reference to the Environmental Protection Plan and the relevant regulations. Our review of the most recent environmental audit findings found that they were relatively clear and straightforward, but that the audit was not conducted by an independent third party. Consequently, there is a possibility of conflict of interest, although we found no evidence of this in our follow-up.

28.70 During construction, the government and developer issued an information booklet on environmental matters affecting the project. In addition, the project's Environment Committee issued an update report in the spring of 1997, noting that there had been no exceptions to compliance.

Tolls

28.71 The Bridge Operating Agreement, signed as part of all the original 1993 project agreements, includes provisions related to the setting of initial tolls, to modifications and to yearly increases. The Agreement also states that all toll revenue must be deposited in a trust account, and reported periodically to the government. The developer may withdraw funds for operating expenses and minor capital expenditures. The excess may be withdrawn from the trust account provided that all provisions in the agreement have been satisfied. The government has the right to audit all related records.

28.72 There is also a toll shortfall clause within the Agreement that permits the developer to apply to the government for recovery of amounts in the event that revenues collected are less than the 1992 ferry revenue indexed to 31 December of

the preceding operating year. Yearly toll increases are limited to 75 percent of the increase in the Consumer Price Index.

28.73 Although the developer is protected against toll revenue shortfalls, there are no provisions limiting the total toll revenue that can be collected in any period. The government's intent was to encourage the developer to operate efficiently and increase toll revenues by attracting additional traffic. It was also expected that the developer would invest profits in the local economy.

28.74 The Agreement required the developer to submit an initial toll proposal no later than six months prior to the opening of the Bridge. It specified that tolls set in the initial year of operation shall be "substantially the same as" 1992 annual ferry revenue indexed to 31 December 1996, using the Consumer Price Index. The government had established this figure to be \$13.9 million.

28.75 Toll negotiations between the government and the developer revolved around two crucial elements: toll rate and toll structure. The toll rate is the amount charged for each vehicle/individual for a round trip use of the bridge. The toll structure establishes vehicle categories (car, bus, truck, etc.).

28.76 During the period of January to May 1997, several toll proposals were submitted to the government by the operator. Each was in turn rejected by the government, primarily because the total estimated annual toll revenue from each proposal would have exceeded the base figure of \$13.9 million. The developer submitted a final proposal shortly before the bridge opened. While the estimated toll revenues still exceeded the base figure, the variance was less than 10 percent, an amount that was deemed to be within the discretion implied in the Agreement by the phrase "substantially the same as". Accordingly, the government approved the rate structure contained in this proposal.

The toll schedule approved by the government was in accordance with the Bridge Operating Agreement.

The Implementation of Federal Environmental Stewardship — 1996, Chapter 2

*Commissioner of the Environment and Sustainable Development: Brian Emmett
Principal: Wayne Cluskey*

Background

28.77 In May 1996, our Office reported on the government's federal environmental stewardship (greening) initiative. We focussed on three aspects:

- the departmental and agency responsibilities under the Code of Environmental Stewardship, including the leadership role of Environment Canada in the implementation of the initiative;
- information dissemination, accessibility and management; and
- the government's ability to demonstrate progress toward the greening of all of its operations.

Scope

28.78 As part of our follow-up, we reviewed two Environment Canada status reports on actions taken — one report prepared in July 1997 for the Public Accounts Committee and a second prepared in July 1998 at our request. We conducted interviews with departments and agencies, and reviewed supporting documentation to assess the extent of progress up to 18 August 1998.

Conclusion

28.79 Although the federal government, with Environment Canada as facilitator, has made progress in response to our observations and recommendations, there remain several important issues that need to be addressed. There is the question of whether the Code of Environmental Stewardship is still in effect for those agencies that did not produce sustainable development strategies and, if not, the impact this has had, or is having, on the government's environmental greening

initiatives in these agencies. We also noted that none of these agencies are represented on the Federal Committee on Environmental Management Systems, even though one of the objectives of this committee is to provide assistance in the development and implementation of the government's greening initiative.

Department's response: Environment Canada agrees with the audit finding that there is a gap between those departments required to submit sustainable development strategies under the amendments to the Auditor General Act and those federal agencies and Crown corporations where the Act does not apply. Environment Canada has an important role to play in encouraging federal agencies and Crown corporations to adopt good environmental management practices. As part of this role, Environment Canada, with the co-operation of the Federal Committee on Environmental Management Systems (FCEMS) and the active participation of the Office of the Commissioner of the Environment and Sustainable Development, will conduct a best practices workshop in the next year for agencies and Crown corporations. The objective of the workshop will be to provide them with information on the government-wide greening initiatives.

Observations

Is the Code of Environmental Stewardship still in effect?

28.80 In May 1996, we noted that although the government had moved the greening process forward for departments and designated agencies with amendments to the Auditor General Act to require sustainable development strategies, the

Progress has been made in response to our 1996 recommendations.

Code of Environmental Stewardship continued to apply to most agencies. It should be noted that these amendments do not apply to Crown corporations and most agencies. There was, and continues to be, no further guidance for implementation of the Code. There is also no definite indication whether the Code continues to apply to those organizations not included in the amendments.

28.81 The implementation of sustainable development strategies (SDSs), tabled by departments and some agencies in December 1997 as required by these amendments to the *Auditor General Act*, will advance the government toward its goal of greening. However, follow-up interviews in two large agencies that have not produced an SDS, indicated that their greening activities have not advanced since our original audit in 1996. One agency has failed to update its environmental action plan, as required by the Code, and there have been no progress reports, while another agency has yet to produce an environmental action plan. In our opinion, this indicates that in those agencies not producing an SDS there is a significant risk that the environmental stewardship initiative has lost momentum and direction.

28.82 Environment Canada, in its status report of July 1998 to the Auditor General, stated that "further clarification between the activities carried out under the *Auditor General Act* vs. the Code [is] no longer required". This does not answer the question as to whether the Code is still in effect and whether it should continue to be applied by those agencies not required to produce a sustainable development strategy.

Can the sharing of information and experiences be expanded?

28.83 Immediately prior to its closure on 31 March 1997, the Office of Federal Environmental Stewardship (OFES) conducted a series of workshops across

Canada, entitled "Greening Government Operations: The New Imperative". These workshops were designed to assist federal departments and interested agencies in meeting their new greening obligations. However, there has not been any follow-up to assess the extent to which departments and agencies were reached, and whether those agencies that were not required to prepare an SDS were in a position to obtain guidance if needed.

28.84 Even with the closing of the OFES, Environment Canada continues to have leadership responsibilities. They continue to be exercised through the Federal Committee on Environmental Management Systems (FCEMS), a working group of the Environmental Accountability Partnership (EAP); it is composed of departments and agencies, the Treasury Board Secretariat and Environment Canada. In our opinion, Environment Canada's involvement and leadership are fundamental to the effectiveness of the FCEMS.

28.85 The FCEMS has a mandate to further sustainable development and support the commitments of the Code of Environmental Stewardship. The objectives of the FCEMS include developing action plans, tools and mechanisms, and assisting in the development and implementation of the government's greening initiative. However, only those departments and agencies that have tabled an SDS in the House of Commons are in fact represented on the FCEMS. We encourage the FCEMS to exercise its mandate with respect to the greening of all government organizations.

28.86 The FCEMS has recently developed a website that captures minutes of meetings, categorizes greening information and provides links to other websites. In our opinion, this development is a step in the right direction, providing that those entities needing guidance are aware of the existence of the website, can access the information easily and can benefit from its content. We note,

Workshops have been held to assist in meeting greening obligations.

There is a risk that greening efforts are losing momentum.

It is not known whether information needs are being met.

however, that Environment Canada does not know which departments and agencies are accessing this site at present and, more important, whether the information provided is fulfilling their needs.

28.87 In our opinion, the opportunity exists for departments and agencies, through the FCEMS, to capture and communicate results and best practices among themselves. As with most environmental challenges, the key to success is senior management

commitment and the communication of that commitment to all employees.

Can the government achieve its goal to green all of its operations?

28.88 Departments and agencies that were required to table a sustainable development strategy, and those that have done so voluntarily, have already benefited or will benefit from a detailed review by the Commissioner of the Environment and Sustainable Development. As noted in the Office of

Exhibit 28.2

Agencies With More Than 100 Full-Time Equivalents (FTEs) That Are Not Required to Prepare a Sustainable Development Strategy and That Did Not Voluntarily Prepare One

	Staff (FTEs)	Budget (\$ millions)
Atomic Energy Control Board	410	47
Canada Labour Relations Board	107	9
Canadian Centre for Management Development	133	17
Canadian Food Inspection Agency	4,414	248
Canadian Grain Commission	745	50
Canadian Human Rights Commission	181	14
Canadian Radio-Television and Telecommunications Commission	415	33
Canadian Security Intelligence Service	2,030	161
Canadian Space Agency	390	185
Canadian Transportation Accident Investigation & Safety Board	241	22
Canadian Transportation Agency	260	22
Federal Court of Canada	431	32
Immigration and Refugee Board	998	77
National Archives of Canada	607	46
National Energy Board	300	28
National Film Board	570	67
National Library of Canada	437	30
National Parole Board	335	24
National Research Council of Canada	3,010	462
Natural Sciences and Engineering Research Council of Canada	191	434
Office of the Commissioner of Official Languages	126	10
Office of the Coordinator Status of Women	109	17
Office of the Superintendent of Financial Institutions	429	46
Privy Council Office	662	64
Public Service Commission	1,344	121
Statistics Canada	4,520	262
Supreme Court of Canada	144	15
Tax Court of Canada	126	10
TOTAL	23,665	2,553

Source: Canadian Ministry Index — Government of Canada Internet Site, June 1997 (not audited)

the Auditor General's own SDS, the Office is committed to encouraging federal organizations that are not required to develop an SDS to do so, or to report on sustainable development issues using other means. Exhibit 28.2 identifies the 28 agencies with more than 100 full-time equivalents that are not required to prepare an SDS and that have not done so voluntarily. These agencies comprise 40 percent of the total agency work force of 58,900 full-time employees, and 8 percent of the total government work force of 282,000 full-time employees, excluding Crown corporations.

28.89 As reported in 1996, Crown corporations, which constituted over 30

percent of the government organizations contacted by the Office of Federal Environmental Stewardship in 1992, remain formally excluded from the greening process under either the Code of Environmental Stewardship, or the amendments to the *Auditor General Act*. Although excluded, Crown corporations were encouraged by Environment Canada to adopt the Code of Environmental Stewardship in their operations. We suggest that the FCEMS contact Crown corporations in an attempt to persuade them to participate in this process, and thereby achieve government-wide application of the greening process, as was the federal government's original intention under the 1990 Green Plan.

We suggest that the Federal Committee on Environmental Management Systems encourage Crown corporations to participate in greening efforts.

Internal Audit in Departments and Agencies — 1996, Chapter 4

Assistant Auditor General: Doug Timmins

Director: Bruce Sloan

Overall, we have noted progress in the quality of internal auditing; however, further progress will be needed to ensure a consistent quality of internal audit across all departments.

Background

28.90 In May 1996 we reported the results of our audit of the internal audit function in federal departments and agencies. We concluded that the quality of internal auditing varied considerably from one organization to another and that internal auditing was not making progress in closing the gap between what might reasonably be expected from the function and its actual performance.

28.91 Our 1996 chapter focussed on five areas:

- the level of management support provided to internal audit;
- audit coverage, that is, the departmental operations that internal audit examined;
- how internal audit groups were measuring their own performance;
- senior management's use of the recommendations in internal audit reports; and
- the extent to which the Treasury Board Secretariat was fulfilling its role as functional leader of the internal audit community.

28.92 Since we reported our findings, the Report of the Independent Review Panel on Modernization of Comptrollership in the Government of Canada has been released. This important initiative establishes an understanding of what modern comptrollership should be within the federal government and describes how comptrollership can contribute to improved management practices within federal government departments. The Panel's report describes an increasingly important role for internal audit within modern comptrollership.

Scope

28.93 Our follow-up audit work consisted of a review of key documents from internal audit groups in a sample of departments across government. We also conducted interviews with Heads of Internal Audit and with officials of the Treasury Board Secretariat to discuss and assess actions taken in response to our 1996 recommendations.

Conclusion

28.94 Overall, we have noted improvement in the quality of internal auditing in the federal government. However, further efforts will be needed to ensure consistent quality of internal audit across all government departments and to fulfil the role envisaged in the Report of the Independent Review Panel on Modernization of Comptrollership. Implementing the recommendations of the Panel needs to be a priority of the government to help ensure that a high-quality internal audit function is demanded and provided across government.

Observations

Senior management support

28.95 Since our audit was completed in 1996, we have noted a more active involvement of the senior management of departments in departmental audit committees. Their activities consist of approving the planned audit coverage of internal audit, reviewing the recommendations contained in the audit reports and monitoring actions taken in response to the recommendation, and the establishment of audit committees where they did not previously exist. These activities provide visible senior management support for the internal audit function and therefore are an important

step in establishing effective internal audit in departments.

28.96 As departments implement the recommendations of the Panel on Modernization of Comptrollership, their understanding of the role that internal audit can and should play in an organization will become increasingly important.

28.97 We did not note any instances where departments had adopted our recommendation to implement the private sector practice of appointing members who are not public servants to their departmental audit committees. We believe that implementing this recommendation would strengthen the role and independence of internal audit.

Scope of internal audit coverage

28.98 In general, we noted an improvement in the extent to which internal audit groups have adopted audit coverage of broad scope in accordance with Treasury Board Secretariat and professional standards. In 1996 we reported that while the majority of internal audit coverage focussed on areas of financial and administrative systems, there was only limited coverage of issues related to efficiency of operations and achievement of established operational objectives.

28.99 As part of our follow-up work, we reviewed a sample of internal audit reports to determine the type of internal audit coverage being carried out. Our review indicated that departmental internal audit groups are taking positive steps to include in their audit coverage audits that focus on assessing the achievement of established operational objectives. In general, such audit work was focussed on objectives within individual operating units. Further progress will be needed to meet the challenges created by the Report of the Panel on Modernization of Comptrollership.

Measuring the performance of internal audit

28.100 In 1996 we reported that approximately half of the internal audit groups had either formal or informal mechanisms for measuring their performance. We also reported that the Treasury Board Secretariat had not reviewed the departmental implementation of its audit policy and standards or the effectiveness of internal audit. Our follow-up audit work indicated that this remains essentially the same today.

Role of the Treasury Board Secretariat

28.101 In 1996 our report raised concerns about the clarity of the government's Review Policy and the confusion that it introduced about what internal audit should be doing. The Report of the Panel on Modernization of Comptrollership also noted a need to clarify the role of internal audit.

28.102 While specific actions have not yet been taken, the Treasury Board Secretariat has indicated its intent to carry out a number of initiatives that will:

- provide direction for the future evolution of internal audit in support of modernized departmental comptrollership;
- recommend changes to the existing policies and standards for internal audit in the federal government, and/or in the way government applies them; and
- examine current and alternative staffing patterns for internal audit in relation to the desired policies and standards, and recommend actions and options for central agencies and for individual departments.

28.103 The Treasury Board Secretariat has stated that it plans to complete these initiatives by 30 September 1999. We will continue to monitor the progress and outcomes of these initiatives and the implementation of the Panel's recommendations on modernizing comptrollership.

The Treasury Board
Secretariat is to carry
out by 30 September
1999 a number of
initiatives to provide
further direction for
internal audit.

Peacekeeping — Foreign Affairs and International Trade and National Defence — 1996, Chapters 6 and 7

*Assistant Auditor General: David Rattray
Director: Paul Morse*

Background

28.104 Foreign Affairs and International Trade views peacekeeping as central to Canada's foreign policy objective of protecting Canada's security within a stable global framework. Over the years, Canada has participated in most peacekeeping missions.

28.105 The nature of United Nations (UN) peacekeeping has changed dramatically in the post-Cold War era. Before, the main role of the UN was largely to monitor truce agreements between states. Now the UN is increasingly called upon to carry out more complex missions that also involve a peace enforcement role, both between and within states. As well, a role for civil-military co-ordination and co-operation has emerged.

28.106 The Canadian Forces have been used extensively on peacekeeping missions. Canada has participated in nearly every United Nations peacekeeping operation as well as other multinational contingency operations, such as the Gulf War. Canadian Forces participation in peacekeeping and contingency operations is in support of the Canadian government's foreign policy.

28.107 At the time of our audit in 1996, over 2,000 Canadian Forces members were deployed on 12 missions, including the NATO Implementation Force (IFOR) in the former Yugoslavia. In 1998, Canada has participated in 11 UN peacekeeping missions. In addition, other international or multinational bodies are engaged in missions that support peace and stability, such as the Multinational Force and Observers in the Sinai, the NATO Stabilization Force (SFOR) in the former

Yugoslavia, and participation in a United States-led force in the Arabian Gulf. Canada is also a participant in the UN's rapid reaction force.

28.108 Canada still has almost 2,000 troops deployed. In 1997–98, the estimated full cost of peacekeeping was \$496 million including UN, NATO, the Multinational Force and Observers. The incremental cost to National Defence is about \$140 million after UN payments are taken into account.

28.109 With respect to Foreign Affairs and International Trade, our 1996 audit addressed the adequacy of information for Parliament, the adequacy of information to ministers for decision making, the extent of Canadian efforts to reform the UN's peacekeeping function, the presentation of the overall cost to Canada of peacekeeping, and the quality of Canada's financial administration of peacekeeping reimbursements from the UN.

28.110 In regard to National Defence, our 1996 audit covered mission planning and information for decision making, the ability of the Canadian Forces to generate peacekeeping and contingency forces, and training and support to operations.

Scope

28.111 Our follow-up covered all subjects addressed in our original audit. We received progress reports from both departments, discussed them with officials and reviewed files and documents to substantiate departmental views or to investigate areas of interest to us. We did not repeat any of our original audit tests as part of our follow-up.

Conclusion

28.112 Foreign Affairs and International Trade continues to hold the view that it is inappropriate to designate a lead department to report to Parliament on peacekeeping. It has thus taken no action on our recommendation that the government name a lead department for that purpose. However, the Department has supported or co-operated with several national and international initiatives to acquire lessons learned and explore alternatives. It has also made efforts to make information on peacekeeping more available.

28.113 National Defence has been successful in addressing most of the internal management problems identified in our 1996 audit. It has greatly improved its internal processes for mission planning and has applied lessons learned. Training plans are being met, even though full brigade training is no longer planned. Equipment has been improved and medical support plans have been made more realistic. Control over deployed materiel has also been much improved.

28.114 One major problem has not been resolved: adequate strategic reconnaissance is not being conducted prior to deployment for all missions. This increases the risk of mission failure.

Observations

Recommendations to Foreign Affairs and International Trade

28.115 Chapter 6 of our 1996 Report examined the role of Foreign Affairs and International Trade in peacekeeping. We recommended that the Department:

- conduct a “standback assessment” in co-operation with other government departments and non-governmental organizations to determine what lessons have been learned;

- consider other possible ways in which Canada could participate in peacekeeping to meet Canada’s objectives, given the fiscal realities in Canada and the UN; and
- ensure more public articulation of the nature and extent of participation in specific missions and the potential for obtaining benefits that Canada wishes to derive. (We noted that better information on the implications and results of peacekeeping efforts was needed.)

28.116 Departmental officials have told us that the Department feels it cannot allocate a high level of resources to peacekeeping activities. It has not taken the approach of leading a major effort to assess Canada’s role in peacekeeping. However, it has taken several initiatives that respond to our recommendation, including the following:

- The Department has supported a number of studies on lessons learned, including:
 - an international study on lessons learned from the UN assistance mission to Rwanda;
 - an in-depth review of how the Department performed as a government department in the Zaire crisis; and
 - papers presented to a conference and intergovernmental meeting on peacekeeping held in 1997 at the University of Halifax.

- The Department has supported the UN Lessons Learned Unit financially and through the Permanent Mission in New York.

28.117 Foreign Affairs and International Trade has participated in several ways to consider alternatives to current peacekeeping methods and help avoid future conflicts. It has taken the leading role in promoting a treaty for a comprehensive ban on anti-personnel land mines. It has created with CIDA a

Collections from the
UN have significantly
improved.

\$10 million “Peacebuilding Fund”. It has also been involved in a number of smaller activities such as providing \$2.5 million to support the Organization for African Unity’s Mechanism for Conflict Prevention, Management and Resolution, and co-chairing the Friends of Rapid Deployment Group in New York.

28.118 Foreign Affairs and International Trade and National Defence provide information to ministers on the implications of a given peacekeeping mission, through aide-memoires that are classified documents to which our Office has only limited access. Foreign Affairs and International Trade claims that the information therein is comprehensive. In addition, it has put information on peacekeeping missions and peacebuilding on its Internet website, but there is little information on the benefits to Canada. The Department has also made efforts to inform parliamentarians through documentation, briefings and visits.

28.119 Our 1996 Report recommended that the government name a lead department to report to Parliament on all significant aspects of Canadian participation in peacekeeping, and specifically on:

- all significant costs;
- additional ways, if any, that were considered for participation in UN peacekeeping; and
- efforts made toward UN reform related to peacekeeping and the results achieved.

28.120 Foreign Affairs and International Trade responded to that recommendation by stating in our Report that it would be inappropriate to designate a single lead agency. The Department maintains that view, and has taken no action.

Collections from the United Nations

28.121 Our 1996 chapter on peacekeeping relating to Foreign Affairs

and International Trade noted that National Defence had taken responsibility for billing the UN for reimbursements and for their collection. The UN reimburses Canada for troop costs, Letters of Assist (such as use of Canadian Forces aircraft), consumable supplies and equipment depreciation. Additionally, claims can be made for death and disability compensation benefits. We noted that billing and collecting was hampered by the difficulty of obtaining the required documentary evidence from in theatre as well as by the complexity of UN systems and requirements. The UN also has a chronic shortage of funds. We concluded that improvements were possible in the administration of reimbursements from the UN.

28.122 National Defence has assigned a full-time staff person to Canada’s Permanent Mission to the UN in New York to deal with claims. For each peacekeeping mission, it now negotiates with the UN a Memorandum of Understanding for Contingent-Owned Equipment. This should prevent some of the serious delays experienced in the past and allow for more accurate estimation of revenue. National Defence recorded revenues of \$32.4 million for 1996–97 and \$41.5 million for 1997–98, despite a drop in UN peacekeeping activity.

28.123 Our 1996 audit recommended that National Defence actively pursue the submission and settlement of claims relating to death and disability. Since then, the Department undertook to recover funds on death, disability and medical claims. Progress has been evident but slow, in part due to the nature of the claims. National Defence completed 16 death claims in 1997 and received \$7.6 million. Another \$200,000 is outstanding. Preparation of disability claims started in May 1997. To date, 10 disability claims have been submitted to the UN for a total of \$7.4 million. A further 30 claims are in progress with an estimated value of \$4 million.

Development of medical claims started in November 1997. To date, 18 claims have been submitted to the UN with a total value of \$1.2 million. A further 33 claims with a total value of about \$1 million are in progress.

Mission planning

28.124 Our 1996 audit found that there had been gaps in deployment planning by the Department of National Defence. We did not find written assessments of whether proposed missions had clear and achievable mandates. The Department had not conducted comprehensive written assessments of each rotation that addressed the feasibility and likelihood of success of the overall mission. Moreover, full reconnaissance — essential to the ability to assess the feasibility and requirements of a mission — had not been carried out for the initial deployment to Bosnia or for the first rotation to Rwanda. We recommended that the Department complete improvements in its staff procedures to resolve these problems.

28.125 Our follow-up found that the Canadian Forces have finally completed major improvements in their staff processes. Detailed staffing procedures for mission planning were approved in April 1998. Nonetheless, staff inspection visits were routinely conducted to each mission in the first month of deployment. Most significantly, the Department has implemented a “lessons learned” process that collects standardized reports from each mission, assesses the relevant lessons and ensures that mission planners have them available for planning each new mission.

28.126 Despite these improvements, adequate strategic reconnaissance was not carried out for the three largest missions conducted since 1996: OPERATION PALLADIUM, the deployment of a battalion group to the former Yugoslavia; OPERATION ASSURANCE, the establishment of a multi-national force

headquarters in Entebbe and later Kampala, Uganda to address the plight of Rwandan refugees in Eastern Zaire; and OPERATION STANDARD/STABLE, the deployment of a battalion-size force to Haiti. Officials told us that “strategic reconnaissance” is reconnaissance aimed at providing information on which to make a decision of whether to deploy, while “tactical reconnaissance” is intended to provide information regarding how to deploy.

28.127 The Department now recognizes that the Canadian Forces do not have the ability to gather the necessary information on which to base clear high-level mission guidance. This can create a “strategic planning vacuum”, rendering Canada vulnerable to the agendas of other states. In part, strategic reconnaissance is not undertaken because the government commits itself to missions before field work can be undertaken. Officials indicated that the government is hesitant to visibly involve the Canadian Forces at an early stage because it might appear that Canada is already committed and thus it would be more difficult not to participate. The Department has advised us that it is considering initiating discussions with other government departments in order to address this problem.

Generating peacekeeping and contingency forces

28.128 Equipment adequacy. Our peacekeeping audit reported that in 1995 the Canadian Forces had concluded that long-standing deficiencies in equipment would not allow troops to perform assigned missions within an acceptable level of risk. In August 1995, the government decided to replace and refurbish the fleet of armoured personnel carriers. It ordered 360 new light armoured vehicles and is considering the Department’s request for an additional 291.

28.129 Our follow-up found that the contract for replacement is proceeding as

Missions are still being mounted without adequate strategic reconnaissance, increasing the risk of failure.

The acquisition of new armoured personnel carriers for peacekeeping troops is proceeding as planned.

planned. The first of the 360 new light armoured vehicles, now called the LAV-3, has been delivered for testing. The remainder will arrive in 1999 and 2000. The Army conducted an equipment rationalization plan in 1997 and concluded that the number of M113s to be refurbished could be reduced from 773 to 406. The remainder will be sold. Effective approval by the Treasury Board for the M113 and Grizzly refurbishment projects is expected in the fall of 1998.

28.130 Our 1996 audit recommended that National Defence prepare and make available to decision makers a fully documented assessment of risk when considering the use of the current armoured personnel carriers and tank trainers in peacekeeping operations. The Department agreed.

28.131 Officials told us that no new missions since 1996 have required these vehicles. The same fleet has remained in Bosnia. We reported in 1996 that additional armour had been added to those vehicles in 1995. Since that time, further protection such as spall liners has been added to one type of personnel carrier — the M113. We did not attempt to assess the impact of the additional armour on the mobility of the vehicles, which had been noted as a problem in our audit. However, officials told us that completed and planned initiatives to improve vehicle power and suspensions would reduce the effect of the added weight.

28.132 Health services. Our 1996 audit concluded that even with a proposed increase in capacity to a 200-bed field hospital to treat casualties, the Canadian Forces would not be able to deploy the minimum force described in the 1994 White Paper without arranging with allies for medical support. For peacekeeping operations, Canadian troops had often relied on medical support provided by other countries, a normal method of operation for all participants in UN missions. We concluded that the Canadian

Forces had not properly justified the number of beds it planned to add.

28.133 Our follow-up found that the Department has completely revised its plans for health service support. It reoriented its analysis to providing medical support for low-level operations across the full spectrum of operations other than war, including peacekeeping. The analysis concluded that for those needs, a modularized field hospital of about 130 beds would be required. Officials project that such a facility will be operational by the year 2004.

28.134 Tasking of personnel. Our 1996 audit found that overall, peacekeeping had not put an excessive burden on individual members of the Canadian Forces. Roughly 80 percent of personnel had served only one six-month tour in a five-year period.

28.135 In 1996 we examined the 1994 White Paper allowance of 3,000 additional personnel for the Army field force. Of the 3,000, 1,600 were added by cancelling planned cuts. National Defence conducted a comparison between manning levels in November 1994 and June 1998 and concluded that the Army field force had increased by over 3,000 personnel.

Reserves

28.136 Our 1996 audit reported that the Militia had not overcome training problems first noted in 1992. On peacekeeping troop rotations in 1994 and 1995, about 20 percent of Militia personnel selected for peacekeeping missions were unable to pass the selection training and evaluation at the lowest level of required individual skills. We therefore reviewed post-operation reports on peacekeeping rotations to Bosnia, Rwanda and Haiti. In 3 of 7 rotations, problems were noted with the training of Reservists volunteering for peacekeeping missions. The Army was unable to provide information on Reserve training overall to indicate whether there had been a general improvement. The Department noted that because training deficiencies are

identified and addressed prior to deployment, it regards the risk to be acceptable.

28.137 Training. In 1996 we found that predeployment training was often inadequate. Units were developing their own training in an unco-ordinated manner and peacekeeping experience was not passed from contingent to contingent or among Commands. Some areas of repeated weakness were noted in mission reports, indicating a poor lessons-learned and training system. Individuals were sometimes deployed even though they had not been fully or consistently trained. We recommended that National Defence develop adequate predeployment training standards and disseminate lessons learned more efficiently.

28.138 The Department has taken action on this recommendation. It issued a Course Training Standard in 1997 for both individual and collective peacekeeping training, and has assessed and revised it since. The Department has also increased central control over the selection and training of individuals for peacekeeping operations.

28.139 In order to improve the dissemination of lessons learned, the Department has completed the implementation of its lessons learned process. It has also established a Peace Support Training Centre responsible for predeployment training of individuals, and has co-ordinated training development with the Pearson Peacekeeping Centre at Cornwallis.

28.140 We reviewed all post-exercise, post-operation and lessons learned reports filed with the Army Lessons Learned Centre in Kingston since 1996. We found that most — if not all — of the individual training deficiencies we noted in 1996 appear to have been corrected. However, lack of adequate strategic reconnaissance and high-level direction during the planning phases of missions has the potential to disrupt training. For example,

in the case of OPERATION ASSURANCE to Central Africa, about 300 troops were deployed before being declared operationally ready. This could have resulted in deployed personnel encountering situations for which they had not been trained.

28.141 Our 1996 audit included the overall collective training program of the Army that supports its general ability to deploy troops. We concluded that peacekeeping operations and budget reductions had resulted in a decline in collective training and had impaired operational readiness. We recommended that the Land Force clarify its concept of readiness, that standards be put in place, and that the Land Force address its inability to complete collective training plans.

28.142 The Department has told us that it has clarified its concept of operational readiness through the issue of a Land Force Order specifying how units are to be declared operationally ready. The Land Force is continuing to implement its performance measurement system. It notes that it completed a collective training exercise at the battle group level (about 1,000 soldiers) in May 1998.

28.143 Our follow-up found that the Army is now able to mostly complete its overall collective training program, but that the program is still concentrating below the brigade level. Current plans call for a composite brigade to be formed if required as a contingency force. The Army therefore trains battalions and brigade headquarters separately, with a view to deploying them together should the need arise. While Army officials believe they can meet 90-day deployment requirements, separate training increases the risk that more time might be required.

28.144 According to officials, units to be deployed are declared ready by the chain of command, using the Army's Battle Task Standards. They informed us that senior headquarters employ a training validation cell independent of the

Deficiencies in mission planning have disrupted training.

The Army has not exercised a full brigade since our audit in 1996. Training is based on its plan to field a composite brigade should one be required.

National Defence has
made progress in
regaining control of
deployed inventory.

battalion being evaluated. They demonstrated that deficiencies are identified and reported to the Chief of the Land Staff.

Support to operations

28.145 Civil-military co-operation. Our 1996 Report observed that recent peacekeeping missions had clearly demonstrated the need for a sound working relationship with such agencies as the UN agencies, private volunteer organizations, local civic leaders and diplomatic staff to address effectively problems such as refugee handling. We recommended that the Canadian Forces ensure that doctrine addressing civil-military co-operation (CIMIC) be finalized quickly and be implemented through appropriate training in all commands. The Department agreed.

28.146 In the fall of 1997, the Canadian Forces Doctrine Board approved the Canadian Forces CIMIC Manual, which aims at the operational level. The manual must be interpreted and applied at the tactical level, where further work is being carried out. The Army has incorporated CIMIC into its collective training; the Pearson Peacekeeping Centre has developed a course on CIMIC; and the Canadian Forces Staff College is presenting the manual as part of officer training.

28.147 Canadian Forces personnel involved in CIMIC are currently deployed in Bosnia. The manual contains a number of recommendations to improve the implementation of CIMIC on missions; however, resource solutions have not yet been found.

28.148 Control of inventory and equipment. Our 1996 audit found that some important controls for inventory and equipment had broken down. We selected a sample of all downward adjustments and write-offs over \$100,000, with an additional 30 items at random. The

Department could not find a significant proportion of the documentation we requested for our sample, and the adjustments remained largely unexplained. We also found a clear lack of inventory control over sea containers sent to one mission. We concluded that the Department had failed to apply the required control over items flowing through the supply system to peacekeeping missions. We also concluded that unexplained adjustments could represent real losses, placing departmental assets at considerable risk.

28.149 National Defence followed up on all the transactions in our sample and although it located much of the supporting documentation, it concluded that almost 28 percent of required documents were in fact unavailable and 30 percent of transactions had some form of error. The Department then conducted its own sampling for 1995–96 missions, and found that 24 percent of transactions still had some form of error. It concluded that this rate of error reflected a failure to apply standard supply policy and procedures.

28.150 Since our audit, the Department has made considerable efforts to regain control:

- Stock and equipment flowing to each mission must now bear a special identifying code in the supply system to permit an audit trail.
- After the first deployment to a mission, changes to the list of items required must go through an approval process.
- The central support unit in Montreal for deployed operations now has responsibility for all second-line items (those items not in current use by the deployed unit). This unit also controls all items acquired as “Unforecasted Operational Requirements”, thereby ensuring that these items are accounted for before being shipped.

- The central support unit in Montreal has instituted a bar coding system that identifies contents of all sea containers.
- Supply staff now participate in reconnaissance missions and are members of the advance party on missions. This smoothes the way for orderly accounting and control over assets on arrival in theatre.
- The Supply Directorate sends a staff inspection visit to each mission after deployment. These visits ensure that there is a full accounting of equipment and stock on hand and that all adjustments are properly approved and documented. Any discrepancies are reported and must be followed up. According to Supply officials, these visits have been very successful in ensuring control in the field.
- Better close-out and hand-over procedures between contingents have been instituted. In addition, automated

inventory management and control have been extended to deployed operations.

28.151 In June 1998, the Deputy Chief of the Defence Staff signed a Direction to Commanders of Operational Deployments that includes a chapter on logistics and a chapter on close-outs. Those chapters have entrenched the improvements noted.

28.152 Staff Inspection Visits have resulted in a number of improvements and cost-saving initiatives. For example, on one mission, 8,000 out of 12,000 spare parts items were found to be dormant. The situation had persisted from one rotation to the next. The dormant items were returned to Canada where they could be used.

28.153 The Department has also improved training for supply functions on missions. Forces personnel have attended a course on UN supply procedures. As well, the Canadian Support Group has been offering predeployment training that has been well attended.

Agriculture and Agri-Food Canada — Animal and Plant Health — Inspection and Regulation — 1996, Chapter 9

*Assistant Auditor General: Don Young
Principal: Neil Maxwell*

Over the last two years, much energy has been devoted to the creation of the Canadian Food Inspection Agency.

A number of initiatives have been undertaken to address our recommendations, but work remains to be done.

Background

28.154 In May 1996, we reported observations and recommendations on the Animal and Plant Health program of Agriculture and Agri-Food Canada. These focussed on program delivery and design, performance measurement and cost recovery, cost avoidance and cost reduction initiatives.

28.155 In 1996, the government decided to consolidate animal and plant health activities and federally mandated food and fish inspection into a single federal agency. On 1 April 1997, the Canadian Food Inspection Agency began operations, assuming responsibility for safety and inspection activities that had previously been spread across three departments — Agriculture and Agri-Food Canada, Health Canada and Fisheries and Oceans. (Inspection activities held in Industry Canada were transferred to Agriculture and Agri-Food Canada prior to the creation of the Agency.)

Scope

28.156 The objectives of our 1998 follow-up were to determine the status of our 1996 recommendations, to identify actions taken and improvements made, and to note any other significant matters that came to our attention.

28.157 Accordingly, we reviewed and tested the July 1997 Department/Agency status report provided to the Standing Committee on Public Accounts in response to the 1996 chapter. We considered all the reported actions, focussing on those that addressed the 1996 recommendations, as well as actions taken subsequent to the July 1997 status report.

Conclusion

28.158 Over the last two years, much energy has been devoted to the creation of the Canadian Food Inspection Agency and to the integration of activities previously performed by the three departments. As noted in Chapter 12 of our September 1998 Report, a number of challenges had to be faced in creating the new Agency.

28.159 Since our 1996 Report, a number of initiatives have been undertaken to address our recommendations; however, work remains to be done. As many of our recommendations were long-term in nature, we did not yet expect the action required to be complete. While many of the actions that have been taken appear to hold promise of satisfying the recommendations, they were not sufficiently advanced for us to draw definitive conclusions that they will address our recommendations fully.

28.160 We encourage the Agency to continue its efforts to implement the applicable recommendations fully. Risk management, resource allocation, performance measurement and new ways of doing business are key to helping the Agency design and deliver programs that are efficient and effective.

Observations

Program design and delivery

28.161 As noted in our 1996 Report, the Agency has a scientific, systematic and rigorous basis for completing risk assessments. This process meets the standards of international treaties and conventions. The risk assessment process represents one aspect of the risk management process used by the Agency. We recommended several improvements to the risk assessment process, in both information gathering and assessment of

information. The Agency has improved its information gathering by enhancing its surveillance activities and incorporating the resulting information into the risk assessment process. However, assessment of the economic impact of threats remains a concern. In the last several months, the Agency has taken some action that it believes will adequately address our concerns. The results of that action will become clear only when the Agency completes its efforts.

28.162 The 1996 Report recommended that risk assessments be completed for all regulated diseases and pests, as well as for other significant diseases, pests, weeds and toxic substances. This required the Department to adjust its focus from the assessment of import requests. The Agency has completed a number of these risk assessments, particularly related to diseases and pests. However, no risk assessments for weeds and toxic substances have been completed. This is despite the fact that in its 1996 response to our chapter, the Department made a specific commitment to carry out risk assessments for known toxic substances. Beyond the Agency's recognition of its responsibility for toxic substances, and the recent creation of a joint working group with Health Canada, little work on toxic substances has been done. Of particular concern is the fact that regulations still have not been developed to prescribe toxic substances, establishing the quantity or concentration allowable, based on risk assessment. With respect to weeds, management has told us that some effort has been given to developing the criteria and methodology for carrying out risk assessments on weeds of quarantine concern but that weeds are not an issue of concern.

28.163 An Agency-Wide Risk-Based Resourcing Project is currently in the conceptual stage. The intent is to create a process to ascertain, through consultation, the risk management priorities for Agency resources, and to identify management

options to effectively and efficiently reduce the risks. Included in this project is a plan to prepare proposals for program redesign based on risk. This latter element of the project appears to address our 1996 recommendation related to the use of risk assessments in determining program-wide priorities and allocating resources. The project is a rather ambitious undertaking, one that has been attempted twice previously. The project has obtained senior management approval and will require several years to complete.

28.164 Over the last two years, changes have been made to the Resource Management System to provide additional information to assist in managing resources. These changes fall short of our recommendation to address the need for reliable management information. As part of its Year 2000 initiatives, the Agency is now developing a new system, the Multi-Commodity Activities Program. If implemented, this system would appear to address our concerns.

28.165 One of the cited benefits of creating the Agency was to enable the government to continue to build on and further develop its programs to provide a more efficient and effective food inspection system. This is consistent with our recommendation that the Agency further examine inspection and other activities with a view to identifying and implementing additional efficiencies in program delivery. The Agency has undertaken a number of major initiatives to achieve this goal. Examples include the Agency-Wide Risk-Based Resourcing Project, mentioned earlier, and the Integrated Inspection System, both of which are still in the conceptual stage of development. The intention of the Integrated Inspection System is to enhance efficiency and effectiveness in the inspection process.

28.166 Alternative service delivery mechanisms continue to be introduced to create additional efficiencies and greater effectiveness. The Business Initiatives

Centre has been working with stakeholders and industry to create a more effective, uniform and streamlined inspection and certification system. The Agency-Wide Risk-Based Resourcing Project and the Integrated Inspection System are new initiatives that are still under development. The alternative service delivery mechanisms and the Business Initiatives Centre are promising initiatives that have resulted in a number of new programs that were developed in co-operation with industry and stakeholders.

28.167 To date, the Agency has made limited progress in the areas of simulation exercises and updating of procedure manuals to assist with preparedness to respond to an incursion of a serious disease or pest. Nonetheless, staff of the Agency continue to receive training and experience. Over the last several years, Canada has contributed staff to a number of foreign countries to assist them in responding to incursions of diseases or pests. Several smaller-scale emergencies in Canada also provide training and experience. In June 1998, the position of Emergency Management Co-ordinator was staffed. This position was created with the goal of developing a single emergency response model for the Agency.

We are concerned that regulations still have not been developed to prescribe toxic substances.

Performance measurement

28.168 Performance measurement provides for results-based accountability through the provision of information on accomplishments achieved against performance expectations and results commitments. This information is important for internal management to control operations and for parliamentarians to ensure accountability. Our 1996 chapter recommended that the Agency develop and use performance indicators, a component of performance measurement, to aid in identifying opportunities to improve the efficiency and effectiveness of program delivery. The

Agency has developed a performance measurement framework, which was included in its Corporate Business Plan tabled in Parliament in 1998. Work continues on the development of performance indicators. Progress to date includes consultations with internal and external experts and the development of an implementation plan. We encourage the Agency to continue work on the indicators.

28.169 In 1996, we recommended that performance results, as measured by performance indicators, be reported to Parliament. We also recommended that other important information related to disease or pest outbreaks of critical significance and to the use of resources be reported to Parliament. Through its Corporate Business Plan and Annual Report, the Agency has provided some information to Parliament on performance results and disease and pest outbreaks. In doing so, the Agency has made progress in its reporting; however, development of the performance measurement process is still ongoing. Additional information on the significance of the diseases and pests that are reported would also be valuable. We encourage the Agency to continue its efforts to improve reporting.

New ways of doing business

28.170 As we noted in 1996, Program Review identified the Animal and Plant Health program as an area where the use of government resources could be reduced. The Agency developed a plan that would use a combination of cost recovery, cost avoidance and cost reduction as a means to adjust to declining resources. Based on this plan, we recommended that the Department determine the level of private good for each service provided. We also recommended that it develop a strategy to recover an appropriate amount of revenue relating to the private benefit portion of the services.

28.171 Prior to the consultations on user fees, the Agency determined a simple range of possible allocations of private and public good. The Agency informed us that during the first two rounds of consultations on user fees, actual user fees were set to respond to industry concerns about competitiveness and the cumulative impact of fees. In 1996, the Department projected that after the third round of consultations on user fees, the overall cost recovery rate would be 20 percent for the Animal and Plant Health program. At the end of the second round, the overall cost recovery rate is estimated to be 13.5 percent. The third round of consultations has been deferred as a result of a moratorium placed by the government on new user fees. As a consequence, it is not clear if the Agency's target will be met.

28.172 As noted previously, the Agency has undertaken several initiatives to assist in the identification of opportunities for efficiency and effectiveness. These initiatives, including the Agency-Wide Risk-Based Resourcing Project, the Integrated Inspection System, alternative service delivery (ASD) mechanisms and the establishment of a new Business Initiatives Centre, generally focus on cost recovery, cost avoidance and cost

reduction. We encourage the Agency to continue to undertake initiatives that examine significant aspects of its operations in order to identify additional opportunities for efficiencies and effectiveness.

28.173 Our 1996 chapter recognized that as new ways of doing business were identified, the role of the Agency might change. It suggested that appropriate systems and practices to approve and then monitor and control activities would become increasingly important. The use of ASD mechanisms, although they are limited in number, has shifted the Agency's responsibilities to standard setting, compliance, monitoring and audit. In this role, the Agency uses control mechanisms throughout the accreditation process, from the application and approval stage through to monitoring and enforcement. The principles guiding some of these control mechanisms are based on International Standards Organization (ISO) guidelines. Penalties, such as loss of accreditation or licence, are also in place for non-compliance. The development of ASD mechanisms and the related assessment of them are relatively new and the potential success of the compliance, monitoring and audit program is not yet known.

It is not clear whether the Agency will meet its target cost recovery rate for user fees.

Revenue Canada — Combating Income Tax Avoidance — 1996, Chapter 11

*Assistant Auditor General: Shahid Minto
Principal: Barry Elkin*

Background

28.174 In our 1996 audit of Revenue Canada's tax avoidance program, we made a number of observations and recommendations about the consultations between Revenue Canada and the Department of Finance, the detection of abusive tax-avoidance schemes, the dissemination of information about the application of the General Anti-Avoidance Rule, the use of fairness provisions in tax settlements and the use of tax shelters.

Scope

28.175 Our follow-up consisted of reviewing status reports prepared by Revenue Canada on the progress it has made on our recommendations. We also reviewed the supporting documentation prepared by Revenue Canada and had discussions with its officials in Ottawa and in the field offices of Toronto-Centre and Toronto-West.

Conclusion

28.176 Revenue Canada has taken action in all areas addressed in our 1996 chapter. It has implemented certain recommendations and has revised relevant administrative policies and practices. Field implementation of the revised policies is progressing slowly.

Observations

Strengthening the legislation

28.177 **Revenue Canada has recommended a penalty for aggressive promoters of tax shelters.** In 1996, we reported on the importance of making legislative changes as soon as possible after tax avoidance schemes are detected.

We note that several legislative changes have been introduced in the last few years to curb the proliferation of abusive tax shelters.

28.178 One aspect raised in our 1996 audit was that Canadian law does not contain a penalty for promoting an abusive tax shelter. Revenue Canada has recommended promoter-penalty legislation to the Department of Finance. The matter was referred to the Minister of Finance's Technical Committee on Business Taxation (Mintz Committee), which supported the need for this penalty in its report released in April 1998. The Department of Finance has not responded yet to this report.

Improving tax administration operations and practices

28.179 **Revenue Canada has not decided whether to deny at-source-deduction hardship waivers for tax shelter losses.** In 1996, we noted that many taxpayers had requested a reduction in their source deductions on the grounds that tax shelter losses would reduce their income tax otherwise payable. Revenue Canada examined its policy regarding at-source-deduction hardship waivers for tax shelters. As a result, the Department extended its review to all cases that are subject to the policy. The review has not been completed yet and a decision is not expected until the end of 1998.

28.180 **The Tax Avoidance and the Large Business Audit units are working together in planning large business audits.** In 1996 we were concerned that the review of tax avoidance issues involving large businesses was not dealt with consistently in all Tax Services Offices. In April 1998, the Department issued a directive that requires that tax avoidance auditors participate in the planning of large business audits in order to obtain assurance that potential tax

Revenue Canada has recommended a penalty for aggressive tax shelter promoters.

avoidance issues are adequately reviewed. Subject to staffing problems in some Tax Services Offices, this directive has been adopted in the field.

28.181 Feedback from appeals sections is infrequent. The appeals process can act as a means of audit quality control, particularly when it results in significant changes to reassessments made by tax avoidance auditors. Although the Department's Appeals Renewal Initiative supports better communications between appeals officers and tax auditors, we noted that the Department had not developed a formalized approach to provide feedback to affected auditors. In the Tax Services Offices we visited, tax avoidance auditors did not routinely receive feedback from appeals officers. The Department has indicated that the existing feedback process will be strengthened before the end of the current fiscal year.

28.182 Information on the application of the General Anti-Avoidance Rule (GAAR) has been improved. In 1996, we reported that tax avoidance auditors did not receive full and relevant information on the decisions of the interdepartmental

committee responsible for the review and application of the General Anti-Avoidance Rule (GAAR). This was particularly important because the courts had not yet spoken on the application of the rule.

28.183 The Department now regularly distributes a summary of the decisions of the GAAR committee to its field tax avoidance auditors. In addition, the Department has provided training and technical information sessions to over 1,500 participants in the last two years. We note that the Tax Court of Canada has rendered two decisions involving the application of GAAR since 1996.

28.184 Some progress has been made in tracking requests to cancel or waive interest and penalties. Many settlements are accompanied or followed by a request from the taxpayer to have all or a portion of applicable interest and penalties waived or cancelled. Revenue Canada is in the process of making system enhancements to track and report interest and penalties waived at the assessment stage. The Department has indicated that reporting of the amounts waived will begin in 1999–2000.

Tax avoidance
auditors do not
routinely receive
feedback from appeals
officers.

Veterans Affairs Canada — Health Care — 1996, Chapter 12

Assistant Auditor General: *Don Young*

Principal: *John O'Brien*

Background

28.185 Our audit reported in May 1996 focussed on the provision of health care by Veterans Affairs Canada to veterans and other eligible recipients. We found that the Department did not have adequate projections of the number of future potential clients or of their anticipated health care needs in order to ensure that it would have the appropriate human, physical and financial resources to address those needs. As a result, the Department did not have comprehensive plans to meet the future health care needs of its clients.

28.186 The audit noted that the Department was paying health care benefits that it considered the responsibility of provincial governments. Other than this issue, we concluded that the Department had satisfactory controls for eligibility for health care benefits.

28.187 We found that the Department had weak controls for the \$172 million expended in 1994–95 (\$161 million in 1997–98) to provide long-term care. In particular, we noted that guidelines for the expected quality of care were not in place. Cost control was deficient because of weak operating agreements with facilities, budgets were received long after the fiscal year began and there were backlogs in conducting operating reviews.

28.188 We observed weaknesses in the financial controls and health care needs assessments for the Veterans Independence Program (VIP). The Program spent \$162 million in 1994–95 (\$150 million in 1997–98) to help recipients live independently and maintain or improve health status. We also found that the Department did not have adequate

empirical evidence to demonstrate the success of the Program.

28.189 We reported that there were opportunities for the Department to save money and improve quality of care in the delivery of its \$173 million (\$189 million in 1997–98) treatment and drug program.

Scope

28.190 Our 1998 follow-up work consisted of a review of documents supplied by the Department to demonstrate progress in responding to our observations. We also interviewed departmental officials to discuss and clarify actions taken.

Conclusion

28.191 The areas of concern that we raised in 1996 can be categorized as resolving responsibility for provision of health care benefits to veterans, improving long-term planning, improving the management of long-term care, strengthening financial controls and health care assessments for the Veterans Independence Program, and increasing the cost effectiveness of the treatment and drug program.

28.192 Our follow-up found that the Department has begun implementing improvements in the treatment and drug program and in its long-term planning. During 1998–99, the Department plans to implement changes in the management of long-term care and in the assessment of the health needs and status of recipients of VIP benefits. The Department continues to pay for certain health care benefits that its legislation states are a provincial responsibility. Financial controls for the Veterans Independence Program have not improved.

28.193 Although many initiatives to improve the management of health care are currently under way, improved results cannot yet be observed.

Observations

Information on future client needs and demographics has been collected and assessed

28.194 Since our 1996 audit, Veterans Affairs Canada has conducted a number of studies to assess the needs of the aging veteran population. These studies were done as part of a major review of the health care needs of its clients. They have identified significant changes that can be expected in the health care needs of a population that is approaching an average age of 80 years. The Department has also conducted additional studies that forecast the demographic characteristics of its potential clientele up to the year 2007.

The Department still requires an approved strategy and plan to meet the health care needs of its clients

28.195 As a result of its Review of Veterans' Care Needs, the Department now has the information necessary to develop a strategy and plan to meet the future needs of its clients. Although it has developed proposed changes to programs and services, there is not yet an approved plan or strategy to implement these changes. The Department plans to have a strategy in place by 31 December 1998.

The Department continues to pay for benefits that its legislation indicates are a provincial responsibility

28.196 Departmental officials have informed us that they are not aware of any further actions by provincial governments, since our audit, to exclude veterans from certain provincial health care benefits available to other provincial residents. However, the Department continues to pay for certain health care benefits that are a

provincial responsibility under Veterans Affairs legislation. The Department has limited authority to deal with broad federal-provincial issues but has indicated that it continues to be attentive to opportunities to address this matter with provinces.

Limited progress has been made in implementing improvements in the management of long-term care

28.197 Our 1996 audit raised a number of concerns about the management of contracted long-term care, including the weaknesses of the agreements with the facilities that provide such care, delays in obtaining and approving the budgets of these facilities, the monitoring of financial performance and quality of care, and limited long-term planning for priority access beds in the future. During our follow-up, we found that the Department was still in the process of developing approaches to resolve these concerns.

28.198 There is little that the Department can do to renegotiate weak transfer agreements that in some cases are over 30 years old. However, the Department has developed a policy that requires at least annual contact with clients in facilities. This contact is to be supported by a structured questionnaire to elicit information on the quality of care provided to the veterans. If concerns are identified, each case is to be referred to a departmental health care professional for in-depth follow-up. If a problem is confirmed, the intention is to resolve the issue with the institution or the relevant provincial health authorities. This procedure was planned to begin in September 1998.

28.199 Beginning in 1999, the Department intends to establish a target of receiving operating budgets for facilities within six weeks of the start of the fiscal year. In one region, financial reviews are still not conducted on a timely basis. In order to improve the timeliness of financial reviews, the Department has

The Department is still in the process of developing approaches to resolve concerns about long-term care.

indicated that it will soon obtain supplemental contracted auditing services to aid existing staff. However, the contract for these services is not yet in place.

28.200 The Department's review of health care needs has identified the expected needs of veterans and developed proposals to deal with these needs in the future. As a result of this study, the Department does not believe that there will be a requirement for an increased number of priority access beds, although the distribution of existing beds may have to change. The Department is currently examining housing and social support options as alternatives to adding new hospital beds.

The Department is strengthening its assessment of the health care needs of recipients of VIP benefits

28.201 In our 1996 audit, we noted that there was a weak link between the VIP benefits provided to recipients and the needs of the recipients. Since then, the Department has developed an approach to managing VIP recipients based on an assessment of health care risks. All clients are to be contacted at least annually to determine if health care status has changed. Counsellors are to focus on the needs of clients identified as having a higher risk of health problems. The information gathered during this process should be useful in assessing the impact of the Veterans Independence Program on recipients' health. The Department planned to begin systematically collecting and reporting this information in 1998. As indicated in the approved audit and evaluation plan, the Department intends to conduct an overall study of the impact of the Program.

Financial controls for the Veterans Independence Program have not improved

28.202 Under the terms of the Program, recipients of VIP benefits are to keep

receipts to show that funds were spent to acquire the services intended. In our 1996 audit, we found that there were poor controls in place to ensure that those who received their payments in advance maintained receipts. The Department's post-payment verification process found that in many cases receipts were not maintained. The Department is exploring options for the delivery of VIP services to clients. These options include moving away from estimated costs to a predetermined amount for each type of service, or establishing operating agreements with registered service providers who could bill the Department directly. However, because of other health care initiatives that are under way, the Department has not taken steps to implement these changes.

Management of the treatment and drug program has significantly improved

28.203 In 1996, we noted that the Veterans Affairs treatment and drug program paid for many more drugs, products and treatments than other similar Canadian programs. We also noted that the Department did not have a system to effectively monitor and control the cost and quality of these services.

28.204 Since 1996, the Department has revised its drug formulary into three categories. The first category of about 6,000 products represents a standard formulary of generally accepted drugs and products. The second category of 1,200 items represents newer, more expensive products. A special authorization unit has been established to authorize the dispensing of these products. The third category includes products that require a client's physician to justify why they are medically effective. For over-the-counter medication, the revised formulary also includes "reasonable use" annual and quarterly dollar limits for specific drugs and products and cumulative limits for all over-the-counter products.

The Department has significantly improved the management of the treatment and drug program.

28.205 To support these changes, the Department has developed a point-of-sale system that is connected to pharmacies throughout Canada. This system was implemented in the Pacific Region in May 1998 and is planned for full implementation by February 1999. The system informs the pharmacist if the Department will pay for an item or if further authorization is required. In addition, the system will inform the pharmacist if the client has a prescription with another pharmacy that may be in conflict with the prescription being filled.

The Department has made limited progress in reducing the cost of providing over-the-counter drugs

28.206 As part of its review of the drug program, the Department retained in its formulary only over-the-counter medications that had a recognized therapeutic effect. About 2,500 of the 6,000 drugs in the standard formulary are over-the-counter medications. The

Department is continuing to negotiate with other provincial authorities to eliminate the dispensing fee for over-the-counter products. The dollar limits discussed in paragraph 28.204 for over-the-counter products should also contribute to cost control over these medications. Departmental officials have informed us that this decision was made in order to maintain control over the use of these products by requiring a prescription, and because many of these products are lower-cost alternatives to prescription medication. Therefore, without renegotiating agreements with the pharmacy associations, the Department will continue to pay a dispensing fee for these products. Veterans Affairs is only one of several federal departments that pays for the cost of treatment and drugs provided to clients. However, the Department has negotiated arrangements with two provincial pharmacy associations to pay a standard markup rather than a dispensing fee.

Revenue Canada and Department of Finance — Excise Duties and Taxes on Selected Commodities — 1996, Chapter 18

*Assistant Auditor General: Shahid Minto
Principal: James Ralston*

There are two broad areas of risk to revenue: evasion through smuggling, illegal or unlicensed production, diversion and other means; and failure by licensed producers to pay the right amount of excise duties and taxes.

Background

28.207 Our September 1996 audit assessed whether Revenue Canada used appropriate and sufficient controls, systems, practices and information to ensure that excise taxes and duties on selected commodities were correctly assessed, collected and reported. We also examined the procedures of the Tax Policy Branch of the Department of Finance to determine whether it monitored and evaluated the tax measures adequately. There are two broad areas of risk to revenue: evasion through smuggling, illegal or unlicensed production, diversion and other means; and failure by licensed producers to pay the right amount of excise duties and taxes.

28.208 We noted that Revenue Canada had strengthened enforcement activities to address evasion and was participating in the government's anti-smuggling initiative that was particularly relevant to combatting evasion of selected commodity taxes. However, this initiative was scheduled to end on 31 March 1997 and we said that continued enhanced, co-ordinated enforcement activities were needed to address the serious and persistent problem of evasion. But we noted that enforcement alone would not eliminate evasion; it was important to regularly analyze the inherent nature and underlying causes of evasion to provide decision makers with current information to develop policies that would address the problem.

28.209 We were concerned that the excise audit strategy and coverage were not adequate. We recommended that Revenue Canada monitor its physical

surveillance of excise duty licensees to determine whether the surveillance program was consistent with the plan to reduce the on-site presence of excise duty officers. Our 1996 audit determined that no excise tax audits had been done on most large licensees in the previous five years, because audit activities had been concentrated on GST accounts that were rated higher in potential for revenue recovery. Because excise tax audits are statute-barred after four years, we were concerned that the Department risked failing to collect significant amounts of revenue. We also recommended that risk analyses be used to select licensees for audit, that audit programs be updated and standardized and that staffing and training needs be addressed.

28.210 We noted that Revenue Canada lacked relevant information and indicators for assessing compliance with the selected commodity tax measures, for monitoring its performance in administering the excise duties and taxes, for allocating resources, for providing accountability and for assisting Finance in its monitoring and policy review. We recommended that it develop appropriate indicators. We also recommended that, given potentially serious fuel tax evasion, Finance consider the need for a review of the fuel excise taxes, similar to the 1993 reviews of the tobacco tax and the jewellery tax.

28.211 Finance, Revenue Canada and affected industries were concerned that many provisions of the *Excise Act* were outmoded and in need of reform. Although there was agreement on the need for a review of the *Excise Act*, Revenue Canada and Finance officials advised that, because of other priorities, the review

begun in 1993 was still in progress. We recommended that completion of this review be completed on an urgent basis because needed changes and desired improvements in administration were being held up by its protracted review.

Scope

28.212 Our follow-up consisted mainly of a review of status reports prepared by Revenue Canada and the Department of Finance in June and July 1998 on the actions taken to address the 1996 recommendations. We also reviewed supporting documentation and conducted interviews with departmental officials to discuss actions taken.

Conclusion

28.213 Revenue Canada has taken steps to address most of our audit concerns. The Assistant Deputy Ministers' (ADM) Anti-Evasion Committee has been formed to provide a forum for integrating strategies aimed at anti-evasion. Other committees are undertaking to analyze the size and causes of evasion problems related to alcohol and fuels. The audit strategy and programs for excise duties have been reviewed and redefined to focus on risk areas. Further effort is required to ensure adequate audit coverage of excise tax licensees. Because evasion of excise taxes is a persistent and serious problem, continuing, sustained efforts are needed.

28.214 The Tax Policy Branch of the Department of Finance continues to monitor indicators of potential excise tax evasion problems and advises that there is no evidence of a need for a fundamental review of fuel excise taxes. In 1996, we were concerned that quicker action was needed on the review of the *Excise Act*. Proposed legislative amendments to the Act are expected soon, taking into consideration consultations with industry associations and members as well as provincial governments.

Observations

Activities to combat evasion

28.215 The three-year anti-smuggling initiative was announced in 1994 to deal with the serious problem of tobacco smuggling. In 1997, the continuation of the initiative was approved, although at lower funding levels. The existing funding of \$27.4 million for Revenue Canada was approved for one additional year (1997–98); thereafter it will be reduced to 85 percent for 1998–99 and to 65 percent for 1999–2000 and beyond. The Department has put in place an Anti-Smuggling Initiative Evaluation Management Working Group to evaluate the impact of this initiative and address funding requirements. Other anti-evasion initiatives such as the Tobacco Export Verification Program, the Alcohol Control Measures Program and the Fuel Tax Administration Project are also continuing.

28.216 Because the various initiatives and ongoing enforcement activities are interconnected, we recommended in 1996 that a focal point be established to minimize duplication, resolve differences in priorities and promote efficiency and effectiveness. The ADMs' Anti-Evasion Committee has now been in operation for over a year. The ADMs' Committee determines the significant evasion problems and looks at overall compliance efforts.

28.217 The Anti-Evasion Division was recently created to consolidate and share information on anti-evasion activities across directorates and regions and to support the ADMs' Anti-Evasion Committee. Although the Division is not yet fully staffed, it is undertaking to co-ordinate the sharing of information about anti-evasion initiatives across regions and directorates in order to avoid duplication and to benefit from lessons learned.

The Assistant Deputy
Ministers
Anti-Evasion
Committee has now
been in operation for
over a year.

Three modest increases in tobacco taxes since 1994 are designed to restore tax revenues with minimal risk of renewed contraband activity.

The target audit coverage of 32 large excise tax licensees is not yet being achieved.

Assessment of the evasion problem

28.218 Our 1996 audit recommended that regular and comprehensive assessments of the extent and causes of evasion be done so that problems at the policy and administrative levels could be appropriately addressed. Since October 1996, Revenue Canada has represented Canada on the Canadian Fuel Tax Uniformity Project, which includes provincial and industry representatives. Its mandate has two main thrusts — harmonization of fuel tax administration and reducing evasion through audit and enforcement. Another departmental initiative under way is a Fuel Tax Study to assess the presence, extent and nature of fuel tax evasion across Canada and the relevant American states.

28.219 We had recommended in 1996 that the Tax Policy Branch of the Department of Finance consider the need for a review of fuel excise taxes. The Department advises that there is no evidence of a need for a fundamental review of fuel excise taxes. Finance does consider particular aspects of fuel excise tax policy where there are indications of potential problems.

28.220 At Revenue Canada, an Intra-Departmental Committee on Alcohol Enforcement and Tax Evasion has just been set up. This committee will provide co-ordination to ensure that the illicit alcohol problem is approached from a department-wide national view. Its activities will include determining the size of the problem and ensuring that gaps that allow evasion are detected and closed.

28.221 The Tax Policy Branch of the Department of Finance continues to monitor various sources of data and to consult with the provinces and other government departments in order to assess the impact of tax policy and legislation on the potential for evasion. Three modest increases in tobacco taxes since 1994 are a direct result of these collaborative efforts and are designed to restore tax revenues

with minimal risk of renewed contraband activity.

Excise audit strategy and audit coverage

28.222 Excise duty is imposed on beer, spirits and tobacco at the point of manufacture. Because these commodities are susceptible to diversion, Revenue Canada conducts on-site surveillance as well as periodic audits. The Department has completed an assessment of its surveillance programs and determined that it has the appropriate balance between surveillance and audits. Excise duty audit programs have also been reviewed and amendments made to remove sections no longer relevant and to improve the sections where potential for revenue loss was identified.

28.223 Excise taxes are imposed on tobacco products, motive fuels, wine, jewellery, automobile air conditioners and certain automobiles at the time of delivery to the purchaser. Excise tax audits are conducted under the umbrella of the GST audit program. Headquarters provides functional guidance to the regions on audit strategy and allocation of resources. In response to our 1996 audit, Revenue Canada stated that large licensees would be audited every second year. The remaining 2,100 small excise tax licensees are to be subject to a two percent audit coverage. In 1997–98, 103 excise taxes audits were carried out, of which three were audits of large entities. It appears that the target coverage of the 32 large licensees is not yet being achieved, since only about 10 percent were audited in 1997–98. Beginning in October 1998, a compliance review program will be available to auditors to assess whether there are any potential excise tax non-compliance issues during the course of an income tax or GST audit of small enterprises.

28.224 Our 1996 audit noted that the number of auditors with excise tax audit experience and good knowledge of

particular industries had declined. Auditors had no formal training in excise duty and taxes or in business practices and computer skills essential to today's audit environment. The Department has developed a self-study course on the basics of excise tax legislation and a more in-depth, instructor-led course is to be made available in the fall of 1998. The excise duty brewery, distillery and enforcement courses have also been rewritten and delivered on a number of occasions.

Monitoring compliance and performance

28.225 We recommended in 1996 that Revenue Canada, in collaboration with the Department of Finance, develop appropriate indicators and analytical data for monitoring compliance and performance, for supporting decision making and for providing accountability. A new Excise Duty Reporting System has been developed to capture client-specific activities, such as production volumes and shipment destination. This system can be used to monitor trends and contribute to intelligence assessments of non-compliance. An Excise Duty Management System has also been put in

place that will be used to develop licensee histories, establish a risk assessment framework, identify areas of non-compliance, maintain a casework database and provide workload and budget analysis.

The *Excise Act* review is progressing

28.226 In 1993, Revenue Canada and Finance began a comprehensive review of the *Excise Act*. The objective was to propose legislation that would provide a fair and modern tax structure, minimize the compliance burden on affected industries and safeguard significant revenue from taxes on alcohol and tobacco products. At the time of our 1996 audit, this review was still in progress but was expected to be completed that year, with draft legislation to be tabled in early 1997. In February 1997, the Ministers of Finance and National Revenue released a discussion paper outlining proposed changes to the structure of taxation of alcohol and tobacco products. A document outlining proposed legislative amendments was being drafted at the time of our follow-up, taking into consideration submissions from and consultations with industry associations and members as well as provincial governments.

**Proposed
amendments to the
Excise Act are
expected shortly.**

Revenue Canada — Creating One Revenue Canada: The Administrative Consolidation of Customs and Excise and Taxation — 1996, Chapter 20

*Assistant Auditor General: Shahid Minto
Principal: James Ralston*

Our 1996 audit focussed on three major aspects: steering the consolidation process, introduction of a single business number and the opening of business window service sites.

Background

28.227 Our 1996 audit looked at whether the process followed in the administrative consolidation of Customs and Excise with Taxation was appropriate and adequately managed and whether the results of some of the significant initiatives demonstrated that stated objectives were being achieved. The audit focussed on three major aspects:

- Revenue Canada's steering of the whole consolidation process at the corporate level;
- introduction of a single business number, which facilitated the consolidation of its registration and information resources; and
- the opening of business window service sites, which entailed the consolidation of human resources from different work cultures.

28.228 Our audit found that senior management had articulated an overall vision of what Revenue Canada would look like with the two departments combined into one. The vision had sufficient detail to guide planning and implementation. Those working on various implementation projects developed the details to attain the vision. Keeping staff informed and maintaining communication with clients were among the guiding principles for consolidation.

28.229 The business number is a unique business identifier that replaced the multiple numbers that Canadian businesses previously had to have to deal with the federal government. It eliminated the need to register separately for payroll

deductions, goods and services tax, corporate tax and import/export duties. Our audit noted that Revenue Canada did a very good job of developing the business number and acknowledged this as a significant accomplishment. We noted that the business number had the potential to improve Revenue Canada's service and enforcement capabilities, but at that point we could only say that the Department was off to a good start. We noted that there was a risk of an overload of work after the 31 December 1996 deadline for conversion, because 60 percent of companies had not yet converted as of 30 April 1996.

28.230 The business window approach allows businesses to access information about Revenue Canada's main business lines through one point of contact. By October 1995, the Department had introduced business windows in 48 offices across Canada, which handled an estimated 3.8 million enquiries per year, mostly telephone enquiries. We noted that the business window had improved access to counter services and should reduce the cost of compliance for most businesses. We found that improvements in telephone service at the business window were still required. Service is measured in terms of the likelihood of a call being answered, the wait times and the accuracy of the information provided. Many staff felt they needed more training to be able to respond confidently to enquiries. Also, the job descriptions and classification of business window staff needed to be reviewed.

28.231 Throughout the implementation of the business window approach, employee communication and involvement were generally good and

stakeholders were adequately informed and involved. In spite of the Department's efforts to deal with the cultural differences of the organizations being merged, many GST staff expressed a "feeling" of being taken over by the larger Taxation group. Dress codes, rules of conduct and hours of work changed and the new organization adopted the Taxation time reporting and production measurement systems.

Scope

28.232 Our follow-up consisted mainly of a review of status reports prepared by Revenue Canada in July and August 1998 on the actions taken to address the 1996 recommendations. We also reviewed supporting documentation provided to us by the Department.

Conclusion

28.233 The envisioned benefits of the administrative consolidation of Customs and Excise with Taxation are being achieved. Resources dedicated to administration and information technology have been reduced. The consolidation of programs such as dispute resolution and redress, and the introduction of the business number system and the business window approach have resulted in greater efficiencies and improved client service.

Observations

Consolidation goals being achieved

28.234 The objectives of administrative consolidation included developing a more effective, consistent and harmonized approach to the delivery of the Department's legislative mandate, enhancing client service and creating opportunities for efficiency gains. These objectives are being realized. For example, the dispute resolution processes for income tax, Canada Pension Plan and Employment Insurance, GST, excise, customs adjudications and trade administration have been consolidated and

single window access to the redress process has been made available. As a result, clients can deal with one contact point for different issues. Harmonized policies and procedures and enhanced information sharing help ensure the consistent application of relevant legislation.

28.235 The number of full-time equivalents dedicated to administration and information technology has declined, attributable at least in part to administrative consolidation. The consolidation also provides departmental employees with more career paths and development opportunities. The management framework that was put in place, including the Strategic Plan and Corporate Accountability Framework, is being updated in preparation for the move toward a new Canada Customs and Revenue Agency.

Business number conversion completed successfully

28.236 All business clients have now been converted to the new business number system. The expected benefits of the business number system are also being realized. Because the business number provides access to a common body of information, auditors and administrators are more aware of cross-program relationships. This has helped to identify new issues of non-compliance, to more accurately estimate revenues at risk and to prioritize and target enforcement efforts. Revenue Canada also has a number of initiatives with several provinces to use the business number to develop a broader range of integrated services.

28.237 Our 1996 audit noted that because of severe time pressures, the testing of the business number system was late and fragmented and that both the former departments lacked a formal quality assurance and control function. An internal task force completed a review of the Department's systems quality assurance process and its recommenda-

The number of full-time equivalents dedicated to administration and information technology has declined.

The use of the business number has helped to identify new issues of non-compliance, to more accurately estimate revenues at risk and to prioritize and target enforcement efforts.

**The Business Window
On-Line Information
System assists agents
to answer questions
quickly and accurately.**

tions for a single consolidated production assurance model are being implemented.

Improvements to business window service

28.238 Improvements in telephone service at the business window are being made. Revenue Canada has implemented an automated voice response system for the business window in the Ottawa, Quebec, Calgary and Vancouver Tax Services Offices. A detailed evaluation of the operation of this system was to be conducted in the fall of 1998 to determine whether it should be expanded to other offices.

28.239 Training profiles have been developed to identify what knowledge and skills business service agents need to answer enquiries accurately and effectively. These profiles will be used to determine what training to give and to integrate training with on-the-job

experience. The Business Window On-Line Information System was developed in 1997 to assist agents to answer questions on all programs quickly and accurately.

28.240 Our audit noted that, as a result of the introduction of the business window approach, officers who were classified at different levels were doing equivalent duties. The job descriptions have been reviewed and a revised job description for more senior business service agents was implemented in February 1998.

28.241 The Department has established national service standards for counter service wait time, telephone accuracy and accessibility. Standards for counter wait time are generally being met. Data on telephone accuracy and accessibility have been compiled and are being analyzed. Findings and recommendations for appropriate action will be reported to senior management.

Federal Contaminated Sites — Management Information on Environmental Costs and Liabilities — 1996, Chapter 22

*Commissioner of the Environment and Sustainable Development: Brian Emmett
Principals: Wayne Cluskey and Dan Rubenstein*

Background

28.242 Focus on central leadership.

Our November 1996 chapter reported on the progress made by the government in developing management information on the environmental risks, costs and liabilities posed by contaminated sites on federal land. The focus of our work was on the federal government's overall management approach toward gathering information on its portfolio of thousands of contaminated sites. Work was also done at three departments with large portfolios of federal land — National Defence, Transport Canada and Indian and Northern Affairs Canada.

28.243 Lack of a complete picture. Our overall conclusion in 1996 was that the federal government did not have a complete picture of its environmental risks, costs and liabilities arising from federal contaminated sites. Nor did it have a timetable to assemble a complete picture. We reported limited central leadership and a lack of accountability for providing this leadership. We concluded that the government was not in a position to adequately assess the risk to health, safety and the environment and to establish the timing and costs for remediation of federal contaminated sites.

Scope

28.244 Focus on progress reports. The starting point of our follow-up work was evidence presented at the Standing Committee on Environment and Sustainable Development on 17 February 1998 by Environment Canada, the Treasury Board Secretariat and Public Works and Government Services Canada.

We then asked Environment Canada, the Treasury Board Secretariat and the interdepartmental Contaminated Sites Management Working Group for a status report of their progress, as at 30 May 1998, in implementing the recommendations in Chapter 22 of our 1996 Report. We conducted a number of interviews and reviews of supporting documentation related to these progress reports. We did not do any detailed work at individual departments.

Conclusion

28.245 Important central leadership issues still remain unresolved. While limited progress has been made in specialized areas, the federal government, the largest landholder in Canada, still does not have a comprehensive view of the potential risks to health, safety and the environment associated with its more than 5,000 contaminated federal sites identified at the time of our November 1996 chapter. Nor does it yet have a complete and accurate view of the related contingent or actual liabilities. Two years after our initial report to Parliament, the government has not developed and implemented a central timetable, and has not finalized and implemented a high-level environmental policy or common standards for due diligence in a consistent manner. It remains unclear whether Environment Canada or the Treasury Board Secretariat is to be accountable for providing the required central leadership. As a result, the government is still unable to assure Parliament and the people of Canada that it is aware of the potential risks to health, safety and the environment, and that it has

The government is still unable to assure Canadians that it is aware of the potential risks to health, safety and the environment.

a comprehensive plan to manage these risks.

Treasury Board Secretariat's response: *The management of contaminated federal sites ultimately resides with those departments that have custody of real property. We are, however, committed to the effective government-wide management of all aspects of real property, including contaminated sites. The Treasury Board Secretariat is committed to ensuring that the issue receives the attention required and is therefore increasing its level of activity. With respect to the observations on the reporting of costs and liabilities, the Secretariat has redrafted its proposed accounting policy taking into consideration comments received from departments. The revised policy will be issued this year and we expect to be in a position to report liabilities, as defined in our draft accounting policy, as at 31 March 1999.*

Observations

Lack of central leadership and clear accountability

28.246 No one organization has overall accountability. No one organization has been assigned the responsibility of ensuring that progress is made against an established timetable for the identification, assessment and ultimate remediation of the portfolio of federal contaminated sites. The government has emphasized that each federal department is responsible for its own clean-up.

A central timetable needs to be established

28.247 Lack of consensus on a central timetable. The government continues to disagree with our Office over the need for a government-wide action plan and timetable to complete the identification, assessment and remediation of all federal

contaminated sites, particularly its high-risk sites.

28.248 Most other organizations we reviewed with a large portfolio of lands take a “portfolio-wide” approach to identifying their highest-risk sites and dealing with them first. However, the federal government continues to take a fragmented approach that raises questions about whether the approach is the right one. Progress is related to each department’s level of interest in dealing with its own contaminated sites. This approach is causing the government problems, as discussed in the section of this follow-up dealing with better government-wide reporting of environmental costs and liabilities.

28.249 The Real Property Management Division at the Treasury Board Secretariat told us that structural or organizational changes had recently been made to better enable it to address horizontal (government-wide) issues. As indicated in its formal response to us, these changes include becoming a “management board” that can assess and respond to government-wide priorities. However, we observed that the exact nature of the role of the management board, as it specifically relates to contaminated sites, remained to be determined.

A comprehensive environmental policy is needed

28.250 Draft policy still to be approved. The Environment Accountability Partnership’s sub-committee on contaminated sites has prepared a draft policy on contaminated sites management. The policy states that contaminated sites on federal land shall be identified, classified, managed and recorded in a consistent manner. At the completion of our follow-up work, this draft policy had yet to be formally approved by the Treasury Board Secretariat and recommended for inclusion in the Real Property Management Manual. Currently, there is

no fixed timetable for the approval and implementation of this draft policy. The Contaminated Sites Management Working Group has been developing a Federal Contaminated Sites Framework, which would provide the specifics necessary to support the draft policy. However, by the completion of our field work in July 1998, the Framework had not been finalized. The Working Group had also developed a discussion paper entitled A Risk Management Framework for Contaminated Sites, which was released in June 1997.

Minimum standards of due diligence need to be defined

28.251 A government-wide position not established. The Contaminated Sites Management Working Group has discussed the issue of due diligence expected of custodial departments, including minimum standards, and the Group has provided courses and training in the area. However, a definitive government policy position, including the extent to which custodial departments should meet the environmental and health standards of provincial and local jurisdictions, has yet to be established, approved and implemented.

Better reporting of costs and liabilities

28.252 Significant work is needed to develop a consolidated estimate. The Treasury Board Secretariat's Government Accounting Policy Division has developed and circulated to departments a draft accounting policy that defines environmental liabilities related to federal contaminated sites. Departments were asked to provide their comments to the policy by 20 March 1998. The plan was that the policy was to be amended by 30 April 1998, based on comments received. Departments would then be asked to report their inventories of contaminated sites and remediation costs to the Secretariat by 30 September 1998, based on the amended policy. The

Treasury Board Secretariat, together with Receiver General staff, would then develop detailed instructions for departmental reporting of environmental costs and liabilities as at 31 March 1999, based on the more detailed departmental comments. As at 31 August 1998, the policy had not yet been amended and circulated to departments.

28.253 Major implementation problems. The comments received on the draft accounting policy from 10 departments managing contaminated sites were fairly consistent. Three departments stated that they would not be able to meet the Treasury Board Secretariat's deadline. One mentioned that it needed a four- to five-year time frame to properly identify, assess and cost the remediation of its contaminated sites. Four departments stated that they needed more guidance now with regard to the nature and extent of the required reporting data before setting up systems to implement the policy. The source of funds to identify, assess and cost the remediation for all sites, as required by the draft accounting policy, was another major concern.

28.254 The preparers of the government's consolidated estimate of federal environmental costs and liabilities continue to be hampered by the lack of central time frames for departments to identify, assess, cost and remediate their contaminated sites. Based on our review of the responses to the Treasury Board Secretariat on the draft accounting policy, it became clear that the Secretariat faces a real problem with implementing the policy by 31 March 1999. We anticipate that some departments will have less difficulty providing the Treasury Board Secretariat with the required data by the targeted date, assuming more guidance is provided. However, other departments reported that they are still at the initial stages of identifying their sites, with only limited funding available to accelerate the pace of their work.

How can the government prepare a complete picture of its contaminated sites without a common timetable?

The federal government continues to take a fragmented approach that raises questions about whether the approach is the right one.

The unresolved governance dilemma

28.255 Capacity to manage horizontal issues is needed. From our perspective, the government faces an unresolved governance dilemma. How will it ensure the readiness of individual departments to comply with the draft accounting policy, given its fragmented approach to the management of its thousands of contaminated sites? How can it ensure that

parliamentarians and Canadians will know the extent of the risk to health, safety and the environment, and the costs of mitigating the potential risks, without a common timetable for the identification and assessment of all federal contaminated sites? These questions will need to be addressed to ensure informed and effective management of contaminated sites.

Materiel Management in the Federal Government — 1996, Chapter 23

Assistant Auditor General: Shahid Minto

Director: Gary Barber

Background

28.256 Since 1980, we have on several occasions identified significant deficiencies in materiel management in the federal government. Our 1996 audit of materiel management confirmed that many deficiencies still existed at that time. Our observations were based on an examination at the Treasury Board Secretariat, Department of National Defence, Natural Resources Canada, Royal Canadian Mounted Police (RCMP), and Fisheries and Oceans.

28.257 We also observed that many initiatives were under way to address the deficiencies. There was a potential to achieve savings of hundreds of millions of dollars. We encouraged the government to develop an effective accountability framework for materiel management.

28.258 On 11 and 12 February 1997, the Standing Committee on Public Accounts held hearings on the results of our audit and a report was issued on 15 April 1997. This report contained several recommendations to the government for improving performance. The Committee stressed the need to clarify the respective roles and responsibilities of the Treasury Board Secretariat and operating departments in the area of materiel management. A report on the status of progress was provided on the government's behalf by the Treasury Board Secretariat to the Committee on 24 April 1998.

Scope

28.259 This follow-up is largely based on discussions with departmental and Treasury Board Secretariat officials on progress since 1996, assertions they have

made in this regard and a review of supporting documentation.

Conclusion

28.260 Although it is too early to determine all the results of the initiatives under way, we are satisfied with the attention given by departments, since the 1996 audit, to improving materiel management. There has been a great deal of progress in achieving savings by closing and consolidating warehouse space, and reductions in inventory levels across government exceed \$480 million. In addition, departments have been improving their materiel management practices and strengthening information systems.

28.261 Furthermore, the Treasury Board Secretariat and Public Works and Government Services Canada expect that the government will resolve, in 1998–99, the long-standing controversy over the mandatory use of the Crown Assets Distribution Directorate.

28.262 The Treasury Board Secretariat told us that its role and relationship with operating departments for materiel management has been further clarified. Deputy ministers of departments, not the Secretariat, are answerable for the management of materiel under their jurisdiction. The Secretariat is responsible for setting standards, providing guidance and monitoring overall performance. The extent to which the Secretariat should be involved in the monitoring of individual departmental performance and the manner of reporting government-wide performance requires further discussion.

Treasury Board Secretariat's response:
We are pleased and agree with the conclusion of the report that the

We are generally satisfied with the progress made in departments since our 1996 report.

The extent to which the Treasury Board Secretariat should be involved in monitoring departmental performance and reporting government-wide performance requires further discussion.

Departments are implementing integrated financial and materiel management information systems.

government has made a great deal of progress in materiel management. We are committed to making further advances in the future through procurement reform, improved disposal mechanisms and processes, including the rationalization of warehousing, and through improved training and professional development programs for the materiel management and supply community. Additionally, the government has invested heavily in the development of information technology infrastructure, which promises to provide improved information for the management of materiel in the future.

Observations

Management information systems

28.263 In 1996, we found that departmental information systems for managing materiel were generally inadequate. Key deficiencies were the variety and incompatibility of systems and the inadequacy of cost and performance information. To make cost-effective decisions, managers needed information on all relevant costs of operations, including materiel. Progress is under way to address these issues.

28.264 Natural Resources Canada and the RCMP are in the process of implementing integrated financial and materiel management information systems. We have been informed that these systems are expected to be fully operational by 31 March 1999. In April 1997, Fisheries and Oceans implemented an integrated financial and materiel management system.

28.265 The Canadian Forces Supply System Upgrade project (CFSSU) was approved by the Treasury Board in 1985. A contract was signed in January 1995 and the end of the project was expected in January 1999. When we reported on it in November 1996, the project represented a high risk of being late, of going over budget and of not meeting National

Defence requirements. Over the past two years, National Defence management and the contractor have switched from a custom-built solution to an off-the-shelf one in an effort to reduce risk. In our December 1997 Report, we reported a revised target date of September 1999. However, as of September 1998, an additional five-month delay had already been recognized and negotiations were under way to establish a new timetable for final delivery of the system. The project management team still expects to meet its overall budget of \$295 million. Although CFSSU remains a high-risk project, we are encouraged by management's efforts to contain both costs and delays while meeting the core requirements for the system.

Inventory and warehouse management

28.266 Too much inventory was being held. Government officials whom we interviewed at the beginning of our 1996 audit said they believed that their organizations had too much inventory. Departments were holding excessive quantities of items that had to be stocked in government warehouses, and also were stocking items that were commercially available and did not have to be stocked. Our 1996 audit found that the magnitude of the overstocking varied with the organization. All of the organizations we examined had initiatives under way to address the problem of holding excess inventory. Since then, reductions of \$483 million in the inventories held by departments are being reported. See Exhibit 28.3.

28.267 National Defence informed us that it will complete its review of the approximately 850,000 line items in its inventory holdings by March 2000. Approximately 200,000 line items have been reviewed and a further 200,000 are currently under review. This review has resulted in a reduction of approximately 15 percent of inventory volume (57,000 cubic metres), with the target being a 30 percent reduction (113,000 cubic

metres) by March 2000. Of the Department's total inventory of \$8.5 billion in 1996, \$6.9 billion was centrally managed in depots and warehouses. Since 1996, the Department reports a reduction of about \$448 million in the centrally managed inventory — from \$6.925 billion to \$6.477 billion.

28.268 Fisheries and Oceans has reviewed its materiel holdings. It reports that these holdings have been reduced by 22 percent, from \$123 million to \$96 million and that the total warehouse and storage space has been reduced by 21 percent, from 173,000 square metres to 136,000 square metres. In May 1998, the Department received the Materiel Management Institute's Materiel Management Recognition Award for its achievements with the Inventory Review Project.

28.269 The RCMP reports that it has reviewed its inventory holdings and reduced them by 28 percent, from \$11.7 million to \$8.4 million. Natural Resources Canada informed us that its inventory holdings have been reduced by 31 percent, from \$14.4 million to \$9.9 million.

28.270 Improvements at National Defence supply depots. In 1996 National Defence consolidated its supply depots in Edmonton, Toronto, Montreal and Moncton into two depots in Montreal and Edmonton. In Montreal, a new warehouse was built to accommodate the consolidation of the Moncton and Toronto

supply depots. We reported that the Department encountered difficulties in consolidating the inventory from the Toronto and Moncton depots into the new Montreal facility. For instance, we found that the warehouse management information system did not have all the information required to make optimum storage decisions and that the materiel storage layout used by the depots was unsuitable for items requiring high turnover and fast response.

28.271 We have been informed that our concerns are being actively addressed. The new warehouse management information system is now fully operational at the Montreal depot. National Defence reports that it has reduced the number of line items held at each depot during the period 1996–98. In Montreal, the number of line items has been reduced from 400,000 to 350,000, while in Edmonton the reduction has been from 300,000 to 277,000.

28.272 Although the greatest reductions in depot size and the number of staff employed occurred prior to 1996, since 1996 National Defence has further reduced the size of its remaining two supply depots and the number of people employed. See Exhibits 28.4 and 28.5.

28.273 Essential records. In 1996 we pointed to the need to improve essential records of materiel holdings in order to maintain complete and accurate inventory records.

28.274 National Defence continues to follow its policy that requires 100 percent

Departments have closed warehouses and reported a reduction of \$483 million in inventory levels.

Department	1996	1998	Reduction
National Defence	\$6,925.0	\$6,477.0	\$448.0
Fisheries and Oceans	\$123.0	\$96.0	\$27.0
RCMP	\$11.7	\$8.4	\$3.3
Natural Resources Canada	\$14.4	\$9.9	\$4.5
Total (approx.)	\$7,074	\$6,591	\$483

Exhibit 28.3

Reduction in Inventories Held by Departments from 1996–1998 (\$ millions)

Source: Departments (not audited)

**National Defence
continues to reduce
the size of its supply
depots.**

physical verification of all materiel over a four-year cycle. During the period January 1996 to December 1997, stock was taken of over 55,000 line items. Adjustments were made where necessary. The Montreal depot implemented an ISO 9002 Quality System, with the objective of a 99 percent accuracy rate. The depot was certified in July 1998. National Defence policy requires that more frequent verifications be performed on certain items such as small arms, large weapons and classified equipment. The Department reports that a recent verification confirmed an accuracy rate of 100 percent on such items.

28.275 The RCMP has informed us that, as of June 1998, the inventory in the warehouse has been verified for accuracy and recorded in the newly implemented warehouse management information system. The RCMP is also in the process of performing a verification of all of its materiel assets and recording this information in its new integrated information system. Progress, however, has been slower than expected and the

original target date of December 1997 was not met. The new target date for completion is March 1999.

28.276 Fisheries and Oceans reports that it has reviewed all of its inventory holdings and approximately 50 percent of the inventory is recorded in the new integrated information system. The remainder of the Department's inventory holdings will be recorded over the next 12 to 18 months. Fisheries and Oceans is also in the process of physical verification of its materiel assets and recording these in the integrated information system. The Department informed us that about 75 percent of its materiel assets are currently recorded and that physical verification of all these items is scheduled to be completed by December 2000.

28.277 Natural Resources Canada informed us that it will have reviewed the records of all of its material assets for accuracy and completeness by 31 December 1998 and that these assets

Exhibit 28.4

Reduction in Size of National Defence Supply Depots
(square metres)

Depot	April 1995	April 1996	April 1998	Change 1996–98
Toronto	89,000	0	0	0
Moncton	51,000	0	0	0
Montreal	162,500	162,500	153,500	9,000
Edmonton	79,000	79,000	73,500	5,500
Total Area (approx.)	381,500	241,500	227,000	14,500

Source: National Defence (not audited)

Exhibit 28.5

Reduction in Personnel at National Defence Supply Depots

Depot	April 1995	April 1996	April 1998	Change 1996–98
Toronto	245	0	0	0
Moncton	238	0	0	0
Montreal	427	427	265	162
Edmonton	255	239	125	114
Total	1,165	666	390	276

Source: National Defence (not audited)

will then be recorded on the new integrated information system.

Policy and management framework

28.278 Accountability framework. In 1996 we found that the essential elements of an effective accountability relationship were missing from the policy and management frameworks for materiel management in departments. We found that roles and responsibilities were unclear and little review of departmental performance was done, which prevented the measurement of performance against expectations.

28.279 Both our 1996 chapter and the subsequent hearings by the Public Accounts Committee raised questions about the appropriate role of the Treasury Board Secretariat in government-wide materiel management.

28.280 In 1997, the Independent Review Panel on Modernization of Comptrollership in the Government of Canada issued its report. The Panel recommended, among other things, that the Secretary of the Treasury Board/Comptroller General:

- establish appropriate standards (and key frameworks) for financial and non-financial information reporting and budgeting for the government as a whole;
- know the extent to which the above-noted standards are met government-wide;
- act to preserve these standards, when necessary; and
- supply government-wide financial and non-financial performance information.

28.281 The Treasury Board Secretariat's work on improving reporting to Parliament and the Panel on Modern Comptrollership have helped to clarify the Secretariat's role. The Secretariat emphasizes that deputy ministers are

solely accountable for the management of materiel in their departments. The Treasury Board Secretariat informs us that it is accountable for two things: first, developing policies and guidelines on materiel management to address the needs of all departments and to address any common problems that may emerge government-wide; and second, providing high-level co-ordination and monitoring within its mandate to ensure "vigorous stewardship of resources and assets" within the government. The Secretariat pointed out to us that the latter does not include ongoing monitoring of the performance of individual departments, nor does it include synthesizing or consolidating information across departments. However, it does include participation in benchmarking materiel management performance against norms in other governments and in the private sector. It also includes providing a general overview of government-wide materiel management issues, initiatives and results in the Secretariat's own Performance Report to Parliament each year.

28.282 Fisheries and Oceans, Natural Resources Canada and the RCMP informed us that they have reviewed their policy and management framework for materiel and that the implementation of new policies is either complete or will be completed by 31 March 1999.

28.283 Although progress to date has been slow at National Defence on implementing its new system for issuing orders and directives (policies), the Department has indicated that it is a high priority to achieve full implementation by April 1999.

28.284 Treasury Board Secretariat information. In 1996 we found that the Treasury Board Secretariat did not have all the information it needed from departments to fulfil its role in monitoring and providing leadership across departments.

28.285 The Secretariat reports that it expects that the necessary information

technology infrastructure that could assist the materiel management function to perform more effectively will begin to be put in place by 1999–2000. The capability and desirability of using these systems to roll up materiel management information across departments for reporting to central agencies such as the Treasury Board Secretariat will be examined.

28.286 Need for sharing best practices information. In 1996 our audit identified problems that cut across several or all of the organizations we audited, and we found that some organizations with similar problems were addressing them in an unco-ordinated manner.

28.287 The Treasury Board Secretariat reports that it has been active in assisting departments to share information on best practices across government. The Secretariat also supports the Materiel Management Institute in some of its endeavours and participates in the Government of Canada Materiel and Supply Management Steering Committee set up by the materiel management community for professional development, provision of policy advice and input to central agencies.

Major accounting changes

28.288 In 1996 we noted the government's intention to implement full accrual accounting by the 2001–02 fiscal year. This would include capitalization of physical assets and accounting for inventories, two key issues related to materiel management. We reported that the change to accrual accounting would enable the government to report annual costs of programs more realistically, give better information to support decisions and improve accountability.

28.289 In February 1998, the Treasury Board Secretariat issued Treasury Board Accounting Standard 3.1, which provided guidance to departments on the capitalization of capital assets and indicated that other accounting issues,

such as inventories, were under review. In Chapter 18 of our September 1998 Report, we reported that as part of its Financial Information Strategy, the government expected that its new central systems would be ready to receive summary-level full accrual-based information from departments starting April 1999. Over the next three years, departments are expected to implement their new financial systems and make the transition from the old central systems to the new. Our future audits will continue to assess the government's progress in this area.

Procurement

28.290 In 1996 we found that not all relevant costs were included in selected materiel acquisitions. We cited the specialized area of ship repairs and overhaul as an illustration. We endorsed the recommendation of an interdepartmental working group that the cost of vessel fuel and crew transportation costs should be a factor in awarding ship repair and refit contracts.

28.291 On 19 December 1996, the Minister of Public Works and Government Services announced that commencing immediately, vessel transfer costs such as fuel costs and crew transportation costs would be included as an evaluation item when soliciting competitive bids for ship repair and refit work.

Disposals

28.292 In 1996 we reported that the use of the Crown Assets Distribution Directorate (CADD), a unit of Public Works and Government Services Canada (PWGSC), remained a mandatory common service for the disposal of surplus Crown assets, despite the 1992 legislative amendments that allowed departments flexibility in disposing of surplus Crown assets (subject to Treasury Board terms and conditions).

28.293 Departmental officials had told us that they could conduct selected disposals themselves more quickly, at less cost, and

achieve higher selling prices than CADD. This view was not fully shared by officials at PWGSC. Our review of selected disposal transactions and the success of various disposal pilot projects had confirmed the need at that time for a thorough analysis of existing disposal operations.

28.294 Public Works and Government Services Canada reviewed its disposal operations in 1997. That study, however, did not result in a resolution of the issue of the mandatory use of CADD. The Deputy Minister then recommended examining the possibility of privatizing the CADD function. A contract was awarded to examine the privatization option. The consulting firm engaged for this purpose presented its findings in July 1998 to departmental senior management as well as to a joint steering committee composed of senior officials from PWGSC and the Treasury Board Secretariat.

28.295 Public Works and Government Services Canada and the Treasury Board Secretariat continue to look for the best solution that would help resolve this long-standing controversy. According to the Secretariat, the government will make a final decision on this matter no later than 31 March 1999.

Public Works and Government Services Canada response: *Despite the 1992 legislative amendments that allowed departments flexibility in disposing of surplus Crown assets, Public Works and Government Services Canada is obligated to continue performing Crown asset disposal until such time as alternative guidelines and disposal mechanisms are implemented.*

Continuing concerns

28.296 Overall, as indicated earlier in this follow-up report, we are generally satisfied with the direction and amount of progress made since our 1996 Report. Nevertheless, we note three areas where we have continuing concerns.

28.297 First, the issue of alternative disposal mechanisms at PWGSC remains unresolved. It is six years since amendments were made to the *Surplus Crown Assets Act* with the intention to allow departments to dispose of surplus assets directly.

28.298 Second, the Treasury Board Secretariat has not made sufficient progress toward strengthening its government-wide monitoring responsibilities. Even in the absence of fully implemented departmental information systems and full accrual accounting, we believe that more could be done so that the Treasury Board Secretariat has a better “big picture” of the status of materiel management in the larger departments of the federal government. For example, departments with important materiel holdings, such as National Defence and Fisheries and Oceans, could be required to report to the Secretariat on major deviations in performance from the departments’ plans.

28.299 Third, the Treasury Board Secretariat needs to provide guidelines and direction to departments concerning the inventory holding costs to be considered when making decisions. Currently, the Secretariat estimates that the annual full cost of holding inventory (including interest on invested capital, warehousing facilities and personnel) is approximately 25 percent of the value of the inventory. However, as departments are not charged interest on the money invested in inventory, they recognize only the direct annual holding costs (such as warehousing facilities and personnel), which are significantly less than the full cost. Not including the interest on invested capital may result in less than optimal decisions being made, particularly when evaluating inventory options that span several years or more.

28.300 We plan to monitor future progress.

The issue of alternative disposal mechanisms at Public Works and Government Services Canada remains unresolved.

Systems under Development — Getting Results — 1996, Chapter 24

Assistant Auditor General: Doug Timmins

Principal: Eric Anttila

The work of the Treasury Board Secretariat in obtaining action plans, monitoring their implementation and consulting with departments is clearly not finished.

Enormous investments in technology continue and although many departments have made improvements, there are still problems that need to be addressed.

Background

28.301 In Chapter 24 of our November 1996 Report of the Auditor General, we reported on our risk assessments of four projects. We recommended that the Treasury Board Secretariat co-operate with departments to produce action plans for the principles discussed in the Enhanced Framework for the Management of Information Technology Projects. In 1997 the Treasury Board Secretariat told us that departments would be expected to develop an improvement plan that focusses on the achievement of goals defined in four plateaus. The first plateau would be March 1998 and the last would be 2002. The plans for the 20 largest departments were to be reported to the Secretariat by March 1998. By the end of September 1998, the Secretariat had received nine of these plans. It has informed us that the others are expected to submit their plans but it is uncertain when this will occur.

28.302 Since September 1997, all new projects submitted by departments for approval by the Secretariat have been required to conform to the best practices in the Enhanced Framework. In addition, the Secretariat has been applying the appropriate principles from the Framework to all Year 2000 projects.

Scope

28.303 The follow-up audit work on the Systems under Development chapter of 1996 was carried out at the Treasury Board Secretariat, Department of National Defence, and at Public Works and Government Services Canada. The findings of the audit were based on interviews with key personnel and review of relevant documentation.

Conclusion

28.304 We agree with the Treasury Board Secretariat that there is still important work to be done in implementing the Framework and in educating senior management on best practices and assuring its commitment to applying them. The work of the Secretariat in obtaining action plans, monitoring their implementation and consulting with departments is clearly not finished. Establishing government-wide mechanisms to assist departments in using the Framework and applying lessons learned from other departments is a key role that the Secretariat can fulfil. It is uniquely positioned for this role since most large information technology (IT) projects are submitted to it for approval.

28.305 Continuing and completing the work begun on the Framework in 1994–95 needs to be a priority. Enormous investments in technology continue and although many departments have made improvements, there are still problems that need to be addressed.

Observations

28.306 Canadian Automated Air Traffic Control System. One of the projects that we reviewed in 1996 was the Canadian Automated Air Traffic Control System (CAATS). This project was transferred to NAV CANADA in November 1996 and is no longer considered to be a major capital project of the government.

28.307 Real Property Services. Management of the Real Property Services set of projects at Public Works and Government Services Canada has continued to pursue the initiatives that we

observed in our December 1997 Report. Governance issues such as business planning and priorities are being addressed. The quality assurance function is being established for a number of the projects, and requirements are being defined before contracts are let. Training is available for all managers. The Department is implementing improvements to its systems development processes in line with the Capability Maturity Model of the Software Engineering Institute. In addition, an innovative approach to project monitoring called the Project Control Panel has been adopted. Project sponsors from the business areas have been identified to ensure that projects remain aligned with business needs. The Department is fully involved with the Treasury Board Secretariat to implement the guidance offered in the Secretariat's Enhanced Framework for the Management of Information Technology Projects.

28.308 Tactical Command, Control and Communications System. The Tactical Command, Control and Communications System (TCCCS) at National Defence is experiencing a one-year delay that is pushing final implementation from September 2000 to September 2001. The overall budget, however, is expected to remain the same. Although some elements of the system have been delivered, the impact on training and operational plans of the Army is significant. A contract amendment is being finalized to establish a new timetable and better project control mechanisms. TCCCS is a complex project that involves some high-risk development work, but the project management team assures us that it is in control and expects to meet its commitments. We will continue to monitor this project, as its overall cost of \$2 billion represents the largest major capital project in systems development in the government today and

its results are critical to the future effectiveness of our land forces.

28.309 Canadian Forces Supply System Upgrade.

The Canadian Forces Supply System Upgrade project (CFSSU) was initiated by National Defence in 1981 and approved by the Treasury Board in 1985. A contract was signed in January 1995 and the end of the project was expected in January 1999. When we reported on it in November 1996, the project represented a high risk of being late, of going over budget and of not meeting the Department's requirements. Over the past two years, National Defence management and the contractor have switched from a custom-built solution to an off-the-shelf one in an effort to reduce risk. In our December 1997 Report, we reported a revised target date of September 1999. However, as of September 1998, an additional five-month delay had already been recognized and negotiations were under way to establish a new timetable for final delivery of the system. The project management team still expects to meet its overall budget of \$295 million. Although CFSSU remains a high-risk project, we are encouraged by management's efforts to contain both costs and delays while meeting the core requirements for the system.

28.310 Action is under way to address recommendations for both CFSSU and TCCCS. As new project phases or contract amendments are worked out, the National Defence project teams have been striving to meet some of our key recommendations on large systems under development projects. These efforts include:

- taking particular care to establish clear project milestones and conditions for their achievement;
- putting in place appropriate performance indicators to better monitor work toward project achievements;

The Tactical Command, Control and Communications System at National Defence is experiencing a one-year delay that is pushing final implementation from September 2000 to September 2001.

As of September 1998, an additional five-month delay for the Canadian Forces Supply System Upgrade project had already been recognized; negotiations were under way to establish a new timetable for the project.

Follow-up of Recommendations in Previous Reports

- designating a project leader at the assistant deputy minister level to be fully responsible for the projects and briefing the leader regularly on progress and project challenges; and
- establishing priorities of time, cost and requirements for project management teams. Exceptions are accepted only after thorough analyses and negotiations with the suppliers.

The Canadian Intelligence Community — Control and Accountability — 1996, Chapter 27

Assistant Auditor General: David Rattray

Principal: Henno Moenting

Background

28.311 In our 1996 audit, we concluded that although substantial arrangements were in place for control and accountability in the Canadian intelligence community, there were opportunities to strengthen them further. We noted that improvements in certain areas, such as community leadership and co-ordination, ministerial direction in the departments of National Defence and Foreign Affairs and International Trade, and performance measurement in the key intelligence collection agencies, would help the community respond to the challenges of a rapidly changing intelligence environment and growing public expectations for improved control and accountability of all public institutions.

Scope

28.312 Our follow-up work included a review of the 1997 status report prepared for the Standing Committee on Public Accounts by the Co-ordinator of Security and Intelligence on the progress made in relation to our observations in 1996. We also reviewed a 1998 update of that status report. We conducted interviews and had discussions with officials in all of the agencies and units that collect, analyze and disseminate foreign and security intelligence as well as those that co-ordinate or review their operations. In addition, we reviewed supporting documentation.

Conclusion

28.313 Based on our follow-up review, we concluded that there has been further progress in strengthening control and accountability arrangements in Canada's

intelligence community. The community has taken action to respond to most of the observations we made in 1996. However, some initiatives are still incomplete.

Observations

Leadership and co-ordination of the intelligence community have been strengthened

28.314 In the area of assessments, the Intelligence Assessments Committee (IAC) and the Intelligence Assessment Secretariat have taken steps to ensure that intelligence assessments respond to the needs of the Prime Minister, Cabinet and ministers. The community has also continued to explore ways to strengthen the contribution to its products. Recent work plans call for contributions from a wider range of organizations in producing assessments. In addition, standing representation at regular IAC meetings has been expanded.

28.315 To aid in managing resources, a strategic review of resource pressures is being conducted at the request of the Co-ordinator of Security and Intelligence.

28.316 Following a 1997 review, the Intelligence Policy Group (IPG) moved to improve the strategic management and co-ordination of relationships with intelligence services of other countries. The IPG and the Interdepartmental Committee on Security and Intelligence (ICSI) regularly discuss and assess the nature of co-operation and these relationships as a whole.

The process for establishing and communicating national intelligence priorities has been enhanced

28.317 Given the broad range of intelligence requirements and issues,

There has been progress in strengthening control and accountability arrangements in Canada's intelligence community.

ministerial involvement in the annual process of setting intelligence priorities continues to be a key element in the control and accountability regime for the Canadian intelligence community. We found that the timeliness of ministers' approval of the national intelligence requirements has improved. Priorities for both 1997–98 and 1998–99 were approved before the end of the preceding fiscal years. In addition, following their approval by ministers, the Co-ordinator of Security and Intelligence now conveys the foreign intelligence priorities formally in writing to ICSI members.

Some steps have been taken to integrate monitoring of community-wide performance with government priority setting and resource management

28.318 In 1997–98, the intelligence community used the national priorities and the results of consultations with intelligence users to identify major collection gaps in a specific and significant collection program, and to take action as appropriate. Although this initiative and the review of resource pressures currently under way (see paragraph 28.315) contribute to the monitoring of community-wide performance, we believe there would be merit in considering the establishment of systematic and ongoing mechanisms for collection agencies to demonstrate results achieved in relation to agreed expectations.

Ministerial control and accountability in the departments of National Defence and Foreign Affairs and International Trade have been strengthened

28.319 To reinforce appropriate ministerial control and accountability, Foreign Affairs and International Trade has consolidated into one document all practices and procedures for managing foreign intelligence activities. The Minister of Foreign Affairs approved this document in late 1996. We believe this

document could be used in the future as a basis for periodic reviews or audits to assure the Minister that the arrangements are working as intended.

28.320 The Department of National Defence (DND) has taken some initial steps toward strengthening ministerial control and accountability of its intelligence activities. The Director General, Intelligence, in consultation with the Judge Advocate General, has produced an Intelligence Activity Authority Matrix describing all DND collection activities, their legal basis and the approving authority. This draft document has yet to be approved by the Deputy Minister and Chief of Defence Staff; however, DND officials anticipate ministerial review and approval before the end of 1998.

Legislative framework for the Communications Security Establishment

28.321 The government has yet to act directly on our observation that a legislative framework for the Communications Security Establishment (CSE) could be of value. Similar recommendations were also made by the Privacy Commissioner (in 1996) and the Communications Security Establishment Commissioner (in 1997). Community officials told us that no decision had yet been made on how to respond to these recommendations.

28.322 At the request of the Co-ordinator of Security and Intelligence, CSE initiated a Mandate and Authorities Project in 1997 to clarify and improve its accountability and policy frameworks. Among other things, the project is designed to strengthen governance and establish a closer accountability relationship between the Chief of CSE and the Minister. CSE officials noted that the accountability framework resulting from this project could be one of the elements helpful to the development of legislation, should the government choose that option.

Plans are under way to conduct compliance reviews in the Communications Security Establishment

28.323 The Communications Security Establishment has established a policy framework that will facilitate future reviews, and is preparing to conduct additional reviews of compliance with its internal policies. A new position, Director of Review Services, has been created and recently staffed. An early task for the Director of Review Services will be to update CSE's review work plan, which will include review priorities.

28.324 We note also that the Communications Security Establishment Commissioner, who was appointed in June 1996 for a three-year term, has been active since his appointment in reviewing CSE's activities to determine whether they comply with applicable laws. The Commissioner has issued two public annual reports during this period and submitted a number of additional reports to the Minister of National Defence.

Relations between the Security Intelligence Review Committee and Parliament have improved

28.325 The Sub-Committee on National Security has not been reconstituted in the present Parliament. New relations are in the process of being developed between Parliament and the Security Intelligence Review Committee (SIRC). In this context, we were informed that appearances by SIRC members and officials before parliamentary committees have gone well in terms of tone and relationships.

Working relations between the Canadian Security Intelligence Service (CSIS) and the Inspector General of CSIS are being monitored

28.326 Although the Inspector General's position is currently vacant, we noted that there had been dialogue during the past two years among the Solicitor General, the Deputy Solicitor General, the Director of the Canadian Security Intelligence Service (CSIS) and the Inspector General on overall relationships. In addition, while the Inspector General provides independent advice to the Solicitor General, we were told that senior government officials regularly monitor working relations and arrangements.

Performance measurement in the Communications Security Establishment and the Canadian Security Intelligence Service has improved

28.327 A responsibility centre for planning, policy and performance measurement for CSE's signals intelligence (SIGINT) activity has been created, and the development of performance measures and success indicators has begun in the context of the business planning process for 1998–99. In addition, CSE has continued to refine the on-line customer requirements and feedback system implemented in 1996. This has improved its ability to measure the performance of its SIGINT program, including assessing the relative contributions of various collection sources to successful SIGINT reporting.

28.328 CSIS officials told us that performance indicators have been developed in a number of program areas, but noted that some aspects of the agency's performance are not readily measurable. The agency is currently studying ways to identify meaningful connections between performance indicators and operational costing.

Agriculture and Agri-Food Canada — The Western Grain Transition Payments Program — 1996, Chapter 28

Assistant Auditor General: *Don Young*

Principal: *Neil Maxwell*

Background

28.329 The Western Grain Transition Payments Program provided \$1.6 billion to Prairie landowners to compensate for the forecasted decline in land values due to the end of the *Western Grain Transportation Act* (Crow Benefit) transportation subsidy in 1995. The decision to end the long-standing subsidy was one component of a significant change in government policy, aimed at reforming the Western grain transportation system. The Program's design and administration were the responsibility of Agriculture and Agri-Food Canada.

28.330 At the time of the audit, the Department had gathered and processed sufficient data for 209,887 landowners to receive an interim payment equal to approximately 71 percent of the total entitlement from the Program. The Program is now complete with the last payment distributed in the 1996–1997 fiscal year.

28.331 Our 1996 audit found that the payments were calculated according to the Program's enabling Act and regulations. We also found that the Department made substantial efforts to ensure that the payments were made on a timely basis. In addition, we performed a limited review of the key internal controls governing the payment process. Nothing came to our attention in the course of this review to suggest that there were significant problems with these payments.

Scope

28.332 The objectives of our 1998 follow-up were to determine the status of our 1996 recommendations, and to note

any other significant matters that came to our attention.

Conclusion

28.333 In general, the Department has taken appropriate steps to implement our recommendations concerning the monitoring and assessment of the aftermath of the Western Grain Transition Payments Program and the end of the Crow Benefit. Given the circumstances, the current approach is reasonable although we would encourage the Department to establish an earlier target date than 2007 for assessing changes. In addition, we would encourage the Department to consider a broader assessment that could incorporate social and environmental impacts.

Observations

28.334 Based on our audit findings in 1996, we made two recommendations. First, we recommended that the Department evaluate the Program to capture lessons for future programs and to assess its impacts, both intended and unintended. The Department has met part of the requirements of this first recommendation by completing a lessons-learned study that looked at implementation of the Program. The study, completed in late 1996, indicated that the Program's administration compared favourably with best practices in its delivery, sound financial management and the quality of client service. The Department is proud of its accomplishments and has circulated copies of the study both within Agriculture and Agri-Food Canada and to other federal departments.

28.335 Our second recommendation in 1996 was that the Department assess the

direction of changes over the long term that were related to crop diversification and the development of value-added processing industries and that were predicted to occur as a result of transportation changes in Western Canada. The Department is currently addressing this recommendation by monitoring four areas: comparative land values between the United States and Canada; on-farm investment as measured by Statistics Canada; level of crop diversification away from traditional grains and oil seeds; and collection of information on specific investments in the value-added processing industry. Officials expect to continue monitoring until the year 2007, at which time they plan to analyze and publicly report on the extent of change in diversification and value-added processing industries, and in land values.

28.336 We questioned departmental officials about why no report would be prepared sooner and they responded that this period would allow enough time for all the resulting changes to take place. Officials told us that it would be possible to produce a report earlier, based on a shorter period of assessment, but there has been no evident demand for an earlier

report. They also told us that in the meantime, they intend to use this information as input to possible changes in federal grain policy.

28.337 Although the Department has done a lessons-learned study and is monitoring long-term economic impacts, it is not presently doing a full evaluation of the intended and unintended impacts of the Program. Most of the economic elements that we expected to see in such an evaluation, such as changes in land values, are part of the long-term monitoring mentioned previously. However, many of the possible unintended impacts of the Program and of the ending of the Crow Benefit are not economic but environmental and social, and are not part of the monitoring regime. Officials told us that they would be willing to broaden their approach to incorporate the monitoring of social and environmental changes. They also pointed out that it would be difficult in practice to attribute changes to specific policies and programs of the federal government and, in particular, connect them directly to the Western Grain Transition Payments Program and the end of the Crow Benefit.

Although the Department has done a lessons-learned study and is monitoring long-term economic impacts, it is not presently doing a full evaluation of the intended and unintended impacts of the Western Grain Transition Payments Program.

Canadian Heritage — Parks Canada — Preserving Canada's Natural Heritage — 1996, Chapter 31

Assistant Auditor General: Richard Flageole
Principal: Ginette Moreau

Background

28.338 Our follow-up audit reviewed corrective action and progress by Parks Canada on the 14 recommendations in Chapter 31 of our November 1996 Report. The purpose of this follow-up was to determine whether the actions taken have corrected, or are correcting, the deficiencies identified in our 1996 audit. The main issues we raised in 1996 concerned the planning systems and management systems of existing national parks. More specific issues were the protection of ecological integrity and the establishment of new national parks and marine conservation areas to complete Canada's network of protected areas.

In releasing the Banff-Bow Valley: "At the Crossroads" Report, the Minister reaffirmed Parks Canada's mandate that nature and ecological integrity will continue to be its first priority while it manages visitor use.

Scope

28.339 We reviewed the 30 June 1997 progress report from Parks Canada to the Standing Committee on Public Accounts. We also incorporated relevant information obtained from Parks Canada and interviewed officials in Ottawa and in the regions.

Conclusion

28.340 Since the 1996 audit, Parks Canada has made some progress in implementing our recommendations, and has demonstrated a willingness to review its actions and to refocus its management. While it has streamlined its organization and operations and developed comprehensive plans to address outstanding issues, how these efforts will be implemented at the park level remains to be seen. While no new parks have been created since 1996, work is continuing toward completing the national parks system. However, it is becoming

increasingly clear that the system will not be complete by the year 2000. Although work is also under way to create new marine conservation areas, Parks Canada has not created any new areas since 1990.

Observations

Parks Canada is providing direction on what it is striving to achieve in the future

28.341 The *Banff-Bow Valley: "At the Crossroads" Report*, prepared by an independent task force and released in October 1996, has had an impact on the management of Banff National Park. It is hoped that it will also affect the way all national parks are managed in the future. In releasing the report, the Minister reaffirmed Parks Canada's mandate as stated in the *National Parks Act* and *Parks Canada: Guiding Principles and Operational Policies* — that nature and ecological integrity will continue to be its first priority while it manages visitor use.

28.342 The Banff National Park Management Plan was released in April 1997. According to the Minister's prefacing message, the Plan incorporates many of the recommendations of the Banff-Bow Valley Report and is "the blueprint for action into the 21st century" and "could be a model for all parks." We believe that Parks Canada would benefit from reflecting the recommendations of the Banff-Bow Valley Report as soon as possible in the management plans of other parks.

28.343 The 1997 State of the Parks Report released in July 1998 contains a lot more comprehensive and valuable information on the situation of national parks in Canada than the 1994 Report. There are 38 national parks and three

marine conservation areas in Canada. The Report indicates that the ecological integrity of 30 national parks is impaired; and in 13 national parks this trend has increased over recent years. In addition, 22 parks have been identified as having severe or major environmental impacts from external sources. The Report provides limited information on the existing marine conservation areas and on progress in establishing new ones.

28.344 We noted that the two previous State of the Parks Reports were presented in 1990 and 1994 respectively. We encourage Parks Canada to respect the obligation to produce the Report every two years, as required under the *National Parks Act*.

Improved collection and use of biophysical and visitor-use baseline data is a prerequisite of future protection and management of national parks

28.345 We believe that Parks Canada has given the importance of biophysical and visitor-use data bases for national parks increased recognition. However, we noted that the quality and quantity of the information included in those data bases varies among parks. The level of effort on data collection presently depends to a large extent on resources available to park superintendents. Parks Canada will need to give a higher priority to acquiring, updating and analyzing the information contained in the data bases for all its parks. This will facilitate the choice of ecological integrity indicators and the development of appropriate monitoring programs.

28.346 The Banff-Bow Valley Report indicated the need to manage visitor use of parks or specific areas where ecological integrity is threatened or likely to be threatened. The decision to act and the justification for controlling access is dependent on having a set of benchmarks, built on sound data bases, against which changes can be measured and impacts

better assessed. Without such benchmarks, damage to the ecological integrity of a site could go unnoticed until it is too late to be rectified.

28.347 Despite the efforts of Parks Canada to move forward in developing ecological integrity indicators, among other things, its has not been able to prevent an increase in the threat, from both external and internal sources, to the ecological integrity of most national parks. Although the government has made a commitment to establish a multilateral panel of experts to review the overall performance of the national parks system in protecting ecological integrity, action has not yet been taken.

Park management plans need to be updated on a timely basis and ecological integrity components developed

28.348 As of September 1998, 16 national parks still did not have up-to-date park management plans. Parks Canada informs us that it is addressing this shortcoming as a priority item, and we encourage action to correct this situation as soon as possible.

28.349 To date, only 21 national parks report having prepared ecological integrity statements (EIS) or drafts of such documents. In its report entitled *Ecological Integrity Statements for National Parks: A Guide to Their Preparation*, Parks Canada committed to completing the preparation of statements for all parks by June 1998; it has since revised the target to March 1999. Further delays could prove costly in the long term to both ecological protection in national parks and the credibility of Parks Canada with the public.

28.350 According to the information gathered from individual parks, 27 national parks report the existence, in whole or in part, of ecological integrity monitoring programs. At least seven of these parks have implemented monitoring programs without first having prepared an EIS. Their monitoring programs rely

Despite the efforts of Parks Canada to move forward, it has not been able to prevent an increase in the threat to the ecological integrity of most national parks.

instead on previously approved management plans and ecosystem conservation plans. We expect that the development of ecological integrity statements will lead to a more uniform application of monitoring programs in all parts of the national parks system.

The establishment of national parks and marine conservation areas remains a priority

On 25 November 1992, the federal government and all provincial and territorial governments committed to make every effort to complete their representative protected area networks by the year 2000.

28.351 On 25 November 1992, the federal government and all provincial and territorial governments signed the *Tri-Council Statement of Commitment to Complete Canada's Networks of Protected Area*. This committed them to make every effort to complete their representative protected area networks by the year 2000. The national parks system is based on having each of the country's 39 natural regions represented by a national park. A preferred park area has not yet been selected in five of the 15 natural regions not yet represented, although potential sites have been identified. Parks Canada officials indicated that the selection is difficult because it requires reaching an agreement with provincial and/or territorial governments and, in some cases, Aboriginal groups and other stakeholders. This situation seriously limits the actions that Parks Canada can undertake to complete the national parks system by the year 2000.

28.352 In 1996 we recommended that Parks Canada update and release its National Parks System Plan and an action plan for completing the national parks system. Although the National Parks System Plan was updated in February 1997, we were informed that there would be no formal action plan. The 1997 State of the Parks Report gives some indication

of actions being taken to complete the system. Parks Canada intends to establish four new marine conservation areas over the next five years. However, there is no action plan for marine conservation areas and none will be prepared. It appears that Parks Canada establishes its priorities on a case-by-case basis, depending on the willingness of partners to proceed. We believe that a more proactive approach is needed.

28.353 In its response to our 1996 audit, Parks Canada stated that pursuant to government direction, it would maintain the course that leads to national parks being owned by all Canadians and managed on behalf of all Canadians. In fact, the *National Parks Act* requires federal government ownership of any national parks land. We are concerned that this requirement will prevent the representation of all natural regions in the national parks system. If action is not taken soon, targeted or potential lands could be developed, leaving no likelihood that Canada or other levels of government will attain publicly stated goals. For that reason, we reiterate our recommendation that Parks Canada study alternative approaches to ensuring that all natural regions are represented.

28.354 In its progress report of 30 June 1997, Parks Canada indicated that amendments to the *National Parks Act* were being prepared to enable the government to add new national parks or enlarge existing ones through a streamlined legislative process, without having to introduce legislation in Parliament. Although this commitment was undertaken in 1994, legislative changes have yet to be presented. Consequently, eight of Canada's national parks are still not protected under the *National Parks Act*.

Canadian Heritage — Parks Canada — Management of Historic Canals — 1996, Chapter 32

Assistant Auditor General: Richard Flageole

Principal: Ginette Moreau

Background

28.355 In 1996 we reported on the management of historic canals by Parks Canada. We made a number of observations concerning accountability as well as strategic, operational and cost-effective management of canals. Our 1996 audit and this follow-up focussed on the management of the Rideau Canal and Trent-Severn Waterway, as these two canals represent over 75 percent of total canal operating costs and the majority of boats moving through locks.

Scope

28.356 We reviewed the status report prepared for the Public Accounts Committee by Parks Canada. We also reviewed the supporting documentation provided to us by Parks Canada and had discussions with its officials.

Conclusion

28.357 Parks Canada has taken steps since 1996 that respond to certain of our recommendations, although progress to address them fully has been slow. We noted that Parks Canada has streamlined its organization and enhanced its program accountability; however, continued attention by management is needed to achieve the projected revenue targets of Parks Canada and thus to continue reducing the gap between revenue and operating expenditure. Parks Canada needs to continue improving the quality of its cost information on canal services and the quality of information on client needs. Better information will support its efforts to promote heritage values and could increase the demand for its services.

Observations

Parks Canada has introduced a more integrated and results-oriented business planning process

28.358 In 1996 we found that the management plans and the business plans of the Rideau Canal and Trent-Severn Waterway did not present a realistic option for the future. They lacked specific operational objectives and time frames for which canal management could be held accountable. Our follow-up review indicates that Parks Canada has introduced a new business planning process for 1998–99. The process integrates into business planning important elements such as the management plans, the commemorative integrity statements and the strategic direction of Parks Canada.

28.359 In the revised planning process, the purpose of the management plan is to indicate the general direction for protection of heritage resources and for the long-term development of each site. The annual business plan identifies the actions, the priorities and the resources required to achieve the intended objectives. Since 1996, the management plans for the Rideau and Trent-Severn have not been modified and therefore still do not, in our opinion, present a realistic option for the future. The new business plans for both canals begin to address the issue of clearer objectives and associated activities, but they still need some work. The new planning process also requires each site to report on progress annually. The first annual reports will be produced at the end of the 1998–99 fiscal year. We are therefore unable at present to assess the full benefit of the annual reporting of results against objectives.

Parks Canada needs to continue improving the quality of its cost information on canal services and the quality of information on client needs.

Parks Canada ought to have a better understanding of the needs of its customers and the elasticity of the demand for its services.

28.360 As a result of its most recent reorganization, Parks Canada has clarified the accountability regime and established a direct line of accountability between senior management responsible for the Rideau Canal and Trent–Severn Waterway and the Assistant Deputy Minister responsible for Parks Canada.

Parks Canada needs to reaffirm its strategy to achieve reduced operating costs and increased revenue at the canals

28.361 In 1996 we noted that Parks Canada had established specific revenue generation and cost reduction targets for the Rideau and Trent–Severn: operating costs were to be reduced by \$3.2 million from 1995–96 to 1997–98. Revenue was to be increased from \$2 million to \$4.8 million from 1995–96 to 1998–99.

28.362 Parks Canada achieved its operating-cost reduction target over the three-year period, but it has not yet achieved its revenue target. At the end of 1997–98, revenue had increased by only \$793,000. However, total revenue for the Trent–Severn and Rideau, which covered 8.9 percent of the total operating costs in 1994–95, now covers 16.6 percent of the total operating costs in 1997–98.

28.363 During our follow-up, we found that, as part of the 1998–99 business planning exercise, Parks Canada has adopted a more realistic revenue generation target for the Rideau Canal and the Trent–Severn Waterway. In order to achieve this objective, Parks Canada must continue to clearly define the measures it intends to implement to further reduce the gap between revenue and operating costs.

28.364 In 1996 we noted that Parks Canada could further reduce operating expenses and increase its revenue. For example, we commented on the need to consider shortening the hours of operation for certain canal locks and/or close infrequently used locks in the Rideau Canal and Trent–Severn Waterway as a

means of reducing its operating costs. However, Parks Canada remains committed to maintaining the same hours of operation for the canals until the year 2000 and to maintaining through navigation for the entire Rideau Canal and Trent–Severn Waterway. It considers that part of the canals' commemorative and historical value is based on the fact that both canals are fully operational man-made canal systems that extend over several hundred kilometres.

28.365 We also noted in 1996 that Parks Canada considered the area of realty rights and privileges to be a major source of revenue growth and that fees would be implemented on a full cost recovery basis. Parks Canada has yet to fully implement these fees, which is one of the reasons it has not achieved its revenue targets.

Parks Canada needs better information on customer needs to increase demand for canal services

28.366 Parks Canada is committed to promoting heritage values and to increasing demand for its various services through marketing initiatives and forging new partnerships with private and public sector stakeholders. We recognize that increased demand does not automatically translate into revenue at Parks Canada, because some of its services relate directly to its mandate of protection and presentation of cultural resources. The fees that Parks Canada charges for its revenue-generating services can also adversely affect demand. In our opinion, Parks Canada ought to have a better understanding of the needs of its customers and the elasticity of the demand for its services. It is also not clear to what degree Parks Canada's ad hoc marketing initiatives or discussions with stakeholders have succeeded, or resulted in increased demand from either water-based or land-based visitors.

28.367 An important element of choosing effective marketing strategies and initiatives is understanding the needs

of the clientele. Since 1996, Parks Canada has made some improvements to the information on canal visitors at the Trent–Severn Waterway and Rideau Canal. We believe that the information currently gathered is insufficient and that Parks Canada needs more relevant and reliable information on its visitors, for management decision making and to contribute to marketing strategies aimed at increasing the demand for canal services.

28.368 Both canals are re-examining their marketing approach. The current marketing plan for the Rideau Canal is outdated; the Trent–Severn Waterway marketing plan lists numerous initiatives but it is not clear how those initiatives will be carried out or who will carry them out. Furthermore, we could not obtain any analysis or report that measures progress or degree of success in achieving the marketing objectives of either marketing plan. We believe that in order to have an impact on demand, both canals still need to select the most appropriate marketing strategies and determine the most effective means to carry them out.

Quality of financial information still requires attention

28.369 Parks Canada will need reliable and detailed cost information for all of its services. This would help it to identify areas where further economies or cost efficiencies can be realized and to establish fair and equitable fees.

28.370 The quality of cost information for the various canal services, which include navigation, water management and flood control, has not improved since 1996. This lack of information prevents Parks Canada from accurately determining

the cost of its services and making informed decisions on cost reductions and/or cost recovery that could contribute to the achievement of further reductions. On 1 April 1998, Canadian Heritage introduced a new Integrated Financial and Material System (IFMS), but managers responsible for the Rideau Canal and the Trent–Severn Waterway have yet to benefit from its intended superior cost-reporting capabilities.

28.371 The lack of cost information also has a direct impact on Parks Canada's ability to analyze the public and private benefits and to establish fair and equitable fees. As noted in 1996, accurately determining the cost of its services and the primary beneficiaries is vital to establish user fees that are fair both to individuals who receive personal benefits and to taxpayers. We recommended that Parks Canada conduct a rigorous analysis of public and private benefits derived from canal systems in order to properly support the establishment of user fees. Such an analysis has not yet been conducted.

28.372 Parks Canada recently approved a *Parks Canada Revenue Policy* (May 1998). The policy defines what Parks Canada considers to be a public or private benefit and addresses the relationship among fees, pricing and cost recovery objectives. It requires that fee proposals be submitted as part of the new business planning process (beginning in 1999–2000) before consultations are initiated with the public. We believe that this new policy is a good first step and, combined with better-quality cost information from the new IFMS, that it should help Parks Canada to make better-informed decisions.

Determining the cost of Parks Canada's services and the primary beneficiaries is vital to establish user fees that are fair to individuals who receive personal benefits and to taxpayers.

Revenue Canada and Department of Finance — Goods and Services Tax: New Housing Rebate and “Self-Supply” — 1996, Chapter 36

*Assistant Auditor General: Shahid Minto
Principal: James Ralston*

Payments under the New Housing Rebate program totalled over \$1 billion in the last three years.

Projects designed to ensure sufficient national audit coverage of builders were not in place at the time of our follow-up.

Background

28.373 Our 1996 chapter focussed on the administration of the GST New Housing Rebate program and of the “self-supply” rules applicable to multiple-unit residential complexes. We also examined how Revenue Canada and the Department of Finance responded to the risk of non-compliance or of difficulties in achieving program objectives.

We recommended that the Department of Finance and Revenue Canada:

- perform an evaluation of the New Housing Rebate program;
- evaluate Revenue Canada’s voluntary disclosure policy; and
- continue to monitor evolving jurisprudence regarding the “house hopper” issue.

We also recommended that Revenue Canada:

- assess whether, on a national basis, there is sufficient audit coverage of builders;
- consider the merits of having a national audit project to address the problem of non-compliance with the self-supply rules;
- ensure that reliable and appropriate information with which to manage the New Housing Rebate program is available on a timely basis; and
- provide guidance on the minimum standard of due diligence expected from builders when determining the eligibility of purchasers from whom they accept an assignment of the New Housing Rebate.

Revenue Canada’s records show payments of \$303 million, \$338 million and \$420 million made under the New Housing Rebate program for the years ended 31 March 1996, 1997 and 1998 respectively.

Scope

28.374 Our follow-up consisted mainly of a review of status reports prepared by Revenue Canada in June and July 1998 on the actions taken to address the 1996 recommendations. We also reviewed supporting documentation and conducted interviews with Revenue Canada and the Department of Finance to discuss and assess actions taken.

Conclusion

28.375 Revenue Canada has initiated action to address many of the recommendations we raised in 1996. It has initiated changes to its voluntary disclosure policy to encourage GST registrants to come forward and correct their accounts. Results of the evolving jurisprudence regarding “house hoppers” indicate a legislative amendment to the *Excise Tax Act* may not be necessary.

28.376 Work remains to be completed in some areas. Revenue Canada has made some improvements to its processing and reporting system for the New Housing Rebate program, but other enhancements are not yet completed. Projects designed to ensure sufficient national audit coverage of builders were not in place at the time of our follow-up. In addition, a review proposed by Revenue Canada to evaluate the merits of having a national audit project to address the problem of non-compliance with the self-supply rules

has not yet been undertaken. The Department has advised us it intends to initiate projects ensuring sufficient audit coverage of builders and the “self-supply” rules by the end of September 1998.

28.377 The Department of Finance and Revenue Canada have no plans to conduct a program evaluation of the New Housing Rebate program. Revenue Canada has also indicated that it feels current guidance on due diligence is sufficient for builders accepting assignment of the New Housing Rebate from purchasers.

Observations

Program evaluation

28.378 Based on a preliminary analysis of the housing market after the implementation of the GST, the Department of Finance does not believe that an evaluation of the New Housing Rebate program is warranted. According to Revenue Canada, it will continue to evaluate the effectiveness of the program by monitoring jurisprudence and through consultation with the Department of Finance and key stakeholders.

Voluntary disclosure

28.379 As a result of the policy review to develop a harmonized disclosure policy for income tax and GST, Revenue Canada has eliminated the six-percent penalty for taxpayers who voluntarily come forward to correct their GST accounts. It believes that this will be an incentive for GST registrants to come forward and voluntarily correct any reporting deficiencies. In addition, the Department has informed us that it has instituted a recording system to track GST voluntary disclosures. Revenue Canada is looking at further changes to the voluntary disclosure policy and, because some of the proposed changes are tied into enforcement actions taken by provincial tax administrations, it is consulting with the provinces.

Monitoring jurisprudence regarding “house hoppers”

28.380 In our 1996 chapter, we expressed concern that a provision of the *Excise Tax Act* that is meant to provide equitable treatment for unincorporated professional builders who construct homes for their personal use may be used by small-scale builders to build homes for resale in a manner that avoids the GST. The term “house hopper” was coined to refer to the individuals involved in such activity. We recommended that Revenue Canada and Finance monitor the evolving jurisprudence in order to determine whether there is a technical problem with the wording of the Act that would need to be remedied by way of legislative amendment.

28.381 Since 1996, the majority of the court cases relating to “house hoppers”, including the result of a judicial review by the Federal Court of Appeal in July 1997, have been settled in favour of Revenue Canada. In view of this fact, Revenue Canada believes a legislative amendment to the *Excise Tax Act* will likely not be necessary.

Sufficient audit coverage of builders

28.382 Revenue Canada has informed us it is taking steps to ensure that there is sufficient coverage of builders. Recent improvements in the Department’s risk assessment system will enable better identification of files with tax at risk, including those in the construction sector. In addition, the information relating to New Housing Rebate payments that are assigned to builders will serve as an additional tool in the selection of workload. The Department planned to send this information to its Tax Services Offices by the end of September 1998 for use in selecting and initiating projects. Since the projects were not in place at the time of our follow-up, we are not yet able to assess the impact of this initiative.

The Department of Finance does not believe an evaluation of the New Housing Rebate program is warranted.

Revenue Canada has eliminated the six-percent penalty for taxpayers who voluntarily come forward to correct their GST accounts.

Some national statistics for the New Housing Rebate program are now prepared on a regular basis.

Project on “self-supply” rules

28.383 Revenue Canada’s review of the merits of having a national project to address the problem of non-compliance with the “self-supply” rules applicable to builders of multiple-unit residential complexes has been delayed. However, the Department informed us that by the end of September 1998 it would advise all Tax Services Offices to initiate projects related to the application of the “self-supply” rules. Since the projects were not in place at the time of our follow-up, we are not yet able to assess the impact of this initiative.

Information for management

28.384 Some changes to the Revenue Canada processing and reporting system for the New Housing Rebate program have been made so that some national statistics are now prepared on a regular

basis. Information to determine work flow, such as reasons why claims are rejected, is not available in the system. Enhancements to the system to produce additional information have not been started due to limited programming resources.

Guidance to builders accepting assignment of New Housing Rebates

28.385 Revenue Canada does not believe there is a need for additional guidance on due diligence to builders accepting assignment of the New Housing Rebate from purchasers. The Department is satisfied to continue the practices we observed at the time of our 1996 audit. These consist of working through industry associations to improve the flow of information and the understanding of eligibility of purchasers for the New Housing Rebate, and providing reminders to the building community.

Revenue Canada — Enforcing the *Income Tax Act* for Large Corporations — 1996, Chapter 37

Assistant Auditor General: Shahid Minto
Principal: Jamie Hood

Background

28.386 In our 1996 audit of Revenue Canada's large file program, we made a number of observations and recommendations about legislative gaps, the way auditors select the issues to audit, the backlog of audits, the reporting of audit results and certain human resource problems.

Scope

28.387 Our follow-up in 1998 included a review of the status report prepared by Revenue Canada on the progress made in addressing our 1996 recommendations. We also reviewed the supporting documentation provided to us by the Department and had discussions with its officials.

Conclusion

28.388 Revenue Canada has taken some action to address several of our recommendations. However, much remains to be done and we are concerned that the problems we identified in 1996 still persist because of the length of time it is taking to address them.

Observations

Use of administrative policies to deal with legislative gaps

28.389 In 1996 we recommended that Revenue Canada and the Department of Finance continue to consult so that legislative changes to reflect accepted administrative policies could be recommended to Parliament sooner. We note in 1998 that there are ongoing consultations between the two departments on such issues.

28.390 With respect to the two particular administrative policies we identified in the 1996 chapter, there have as yet been no recommendations to Parliament to change the legislation. This is particularly troubling in the area of interest deductibility, where the administrative policy does not fully reflect the law as interpreted by the courts.

28.391 The second administrative policy dealt with the utilization of losses within a corporate group. The Minister of Finance's Technical Committee on Business Taxation raised this issue in its report and the Department of Finance is currently studying that report.

Improvements are still needed in audit practices and reporting of program results

28.392 Selecting the right issues to audit is a primary key to success. In 1996 we noted several opportunities for Revenue Canada to help its auditors improve the process they use to select audit issues and to give management the assurance that the highest-risk areas of possible non-compliance are being reviewed. The Department issued some directives about this subject earlier this year and has plans to issue others. However, it will take some time for the information contained in the directives to be reflected in the way auditors do their work. We encourage the Department to issue the remaining directives as quickly as possible and to provide appropriate training to its auditors so that the recommended approaches are fully understood and applied.

28.393 In 1996 we noted that the Department had an action plan to reduce the interval between the time a return is assessed and the time it is audited. Improvements continue to be made in this area.

28.394 Providing Parliament with complete information on program results

We are concerned that the problems we identified in 1996 still persist.

is important. In 1996 we recommended that Revenue Canada supplement the information it reported to Parliament on the results of the large file program with information on actual taxes billed or refunded and information on subsequent appeals. We recognize that there has been a change in the Estimates documents since 1996. However, our review of both Revenue Canada's 1998–99 Report on Plans and Priorities and its 1997–98 Performance Report show that less information is now being provided to Parliament on the results of the large file program than was the case in 1996. We are convinced that the Department needs to find ways within the new structure to

fully implement our 1996 recommendation.

Some human resource problems persist

28.395 We observed a number of human resource issues in 1996 that were creating barriers to achieving better results in the large file program and we made several recommendations for improvements. In our follow-up we found that the Department has made some progress in addressing our recommendations, particularly through the staffing design team for the proposed Canada Customs and Revenue Agency, although there are still difficulties in staffing positions in some regions.

Chapter 29

Other Audit Observations

The work that led to other audit observations was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Main Points

29.1 The *Auditor General Act* requires the Auditor General to include in his Reports matters of significance that, in his opinion, should be brought to the attention of the House of Commons.

29.2 The “Other Audit Observations” chapter fulfils a special role in the Reports. Other chapters normally describe the findings of the comprehensive audits we perform in particular departments; or they report on audits and studies of issues that relate to operations of the government as a whole. This chapter reports on specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations and other entities, or during our value-for-money audits.

29.3 The chapter normally contains observations concerning departmental expenditures and/or revenues. The issues addressed generally involve failure to comply with authorities, and the expenditure of money without due regard to economy.

29.4 Observations reported this year cover the following:

- ongoing issues between Atomic Energy of Canada Limited and the government that need to be resolved;
- transparency and the government’s Annual Financial Report;
- concerns about poor control over computers loaned to employees for home use;
- the urgent need for an updated long-term comprehensive plan to restore and renovate the Parliamentary Precinct; and
- fairness in the Canadian income tax system.

29.5 Although the individual audit observations report matters of significance, they should not be used as a basis for drawing conclusions about matters we did not examine.

Introduction

29.6 This chapter contains matters of significance that are not included elsewhere in the Report and that we believe should be drawn to the attention of the House of Commons. The matters reported were noted during our financial and compliance audits of the Accounts of Canada, Crown corporations and other entities, or during our value-for-money audits.

29.7 Section 7(2) of the *Auditor General Act* requires the Auditor General to call to the attention of the House of Commons any significant cases where he has observed that:

- accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;
- essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property; to secure an effective check on the assessment, collection and proper allocation of the revenue; and to ensure

that expenditures have been made only as authorized;

- money has been expended other than for purposes for which it was appropriated by Parliament;
- money has been expended without due regard to economy or efficiency;
- satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or
- money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

29.8 Each of the matters of significance reported in this chapter was examined in accordance with generally accepted auditing standards; accordingly, our examinations included such tests and other procedures as we considered necessary in the circumstances. The matters reported should not be used as a basis for drawing conclusions about matters not examined. The instances that we have observed are described in this chapter under the appropriate department headings.

This chapter contains a number of observations on matters of significance not included elsewhere in the Report.

Atomic Energy of Canada Limited

Assistant Auditor General: John Wiersema

Director: Dale Shier

Ongoing issues between Atomic Energy of Canada Limited and the government need to be resolved

While the government has approved Atomic Energy of Canada Limited's (AECL) annual operating and capital budgets, in each of the past three years it has not approved AECL's five-year corporate plans. Consequently, the related corporate plan summaries have not been tabled in Parliament. There are no other situations where a Crown corporation's corporate plan has not been approved for three years. In the circumstances, the process contemplated in the Financial Administration Act (FAA) for approval of a Crown corporation's objectives and its strategies for achieving them is not functioning in the case of AECL. Further, Parliament's needs for timely information on AECL's plans, communicated through a corporate plan summary, are not being met as contemplated by the FAA.

Atomic Energy of Canada Limited and the government are working together to resolve outstanding issues, including the future of Whiteshell Laboratories and responsibilities related to nuclear waste. Resolution should provide consensus on important issues, and allow the corporation to manage its business with that consensus in mind. In our view, it is important that these current efforts succeed.

Background

While Program Review focussed on government funding of AECL, other ongoing issues remain.

29.9 As part of its Program Review of government operations, the government reviewed Atomic Energy of Canada Limited's operations about two years ago. This review confirmed government support for AECL, but resulted in decreases in the government's annual funding of the corporation's nuclear research activities. In 1996–97, the government's annual contribution to AECL was about \$170 million a year. This will decrease to approximately \$100 million for the fiscal year 1998–99.

29.10 Program Review recommended that the corporation focus on commercial business. As a result, AECL eliminated certain research activities not related to such commercial products as CANDU power reactors. The corporation also began a restructuring program to reduce its costs in order to allow it to continue

operating with the reduced annual government funding.

29.11 While Program Review focussed on government funding of AECL, other ongoing issues remain. For each of the six years ended 31 March 1997, the auditors' reports on AECL's financial statements contained reservations of opinion because the corporation had not recorded a liability for its decommissioning and site remediation costs in its financial statements. As of late October 1998, AECL's annual report for the year ended 31 March 1998 had not yet been submitted to the Minister of Natural Resources. Finally, in Appendix D of this Report, we note that the Governor in Council has not approved AECL's five-year corporate plans for over three years. This observation describes developments subsequent to 31 March 1997 relating to some current issues facing AECL, and their implications to the corporation and to Parliament.

Issues

29.12 Ongoing issues between AECL and the government. In early 1998, AECL and the government agreed to deal with a number of outstanding issues in time for implementation in the corporation's 1999–2000 fiscal year. There are two broad areas under discussion: AECL's commercial CANDU reactor business and the corporation's sites, including related nuclear decommissioning and waste.

29.13 Some specific issues facing AECL include the following:

- **The corporation needs a clear decision from the government on the future of Whiteshell Laboratories in order to complete implementation of Program Review decisions, and to manage its business effectively.** To date, AECL has restructured its operations, including closure of some AECL offices, reduction of other offices, layoffs of staff, and elimination of certain research programs not linked directly to the CANDU business.

Almost two years ago, in December 1996, the government decided to find a private sector operator to commercialize the corporation's Whiteshell operations. Around that time, the government asked AECL to halt any future layoffs at Whiteshell while the commercialization proceeded. However, commercialization efforts failed, and in 1998 the corporation laid off about 250 full-time Whiteshell employees. This left approximately 330 full-time employees at Whiteshell Laboratories as of September 1998. The ultimate future of Whiteshell Laboratories remains uncertain.

- **Roles and responsibilities concerning nuclear waste on AECL's sites need to be clarified.** Until recently, the government funded AECL's nuclear decommissioning and waste activities through annual appropriations. Now these activities are funded by a 10-year

agreement whereby AECL will apply the proceeds of heavy water revenue to this purpose. If the 10-year agreement is not extended, funding is to revert to the former annual funding arrangement. AECL currently spends approximately \$15 million annually on waste activities.

In 1997, AECL completed a comprehensive plan for its nuclear facilities and waste. The plan contemplates that the corporation's main research facility at Chalk River, Ontario will remain an active nuclear site for 75 years, and that waste-related activities will continue for 100 years. The corporation estimates that the current discounted cost of all necessary activities is \$400 million. Because of the effect of the time-value of money over the 100-year clean-up period, actual expenditures will be higher than the discounted cost.

As noted previously, one of the areas currently under discussion between the corporation and the government is AECL's sites, including related nuclear decommissioning and waste. These discussions should clarify roles for nuclear waste at AECL's sites in the future.

29.14 Other issues facing AECL.

Other issues facing the corporation include the implications for the corporation's cash requirements of a cyclical market for sales of CANDU reactors, and the generally old facilities at Chalk River Laboratories, particularly future closure of AECL's 40-year-old research reactor. This reactor is used for CANDU-related research and other scientific research.

29.15 The Crown corporation accountability framework contemplates annual government approval of AECL's plans, but this has not happened since 1994–95.

The corporate plan is one of the key components of the accountability regime established for Crown corporations through the *Financial Administration Act*. It sets out management's and the Board of Directors' direction for the corporation and, through the mechanism for approval,

The Governor in Council has not approved AECL's five-year corporate plans for over three years.

provides for government capability to influence that direction. A summary of approved plans is then provided to Parliament so that all can know the corporation's objectives and its plans for achieving them. Finally, in their accountability regime, Crown corporations report annually to Parliament through their annual reports on the extent to which those objectives have been met.

29.16 AECL has submitted annual operating and capital budgets each year, and these have been approved by the government and tabled in Parliament. However, while AECL has also submitted five-year corporate plans each year, they have not been approved by the Governor in Council since 1994–95. This was also the last year for which a corporate plan summary was tabled in Parliament. There are no other situations where a Crown corporation's corporate plan has not been approved for over three years. In the circumstances, the process contemplated by the *Financial Administration Act* for approval and communication of a Crown corporation's strategic direction is not functioning in the case of AECL.

29.17 The lack of an approved corporate plan since 1994–95 also means that the last AECL corporate plan summary tabled in Parliament was almost

three years ago, in December 1995, instead of annually as contemplated by the *Financial Administration Act*. AECL is changing rapidly, in response both to Program Review and the commercial marketplace. In this time of change, parliamentarians have not been informed of AECL's plans.

29.18 The relationship between the corporation, government and Parliament is not in keeping with the accountability framework set out in the *Financial Administration Act*. However, the government and AECL continue to discuss the future of the Whiteshell Laboratories, and the separate current discussions between AECL and the government are intended to address many of the other outstanding issues. These initiatives need to be seen through to a timely, successful resolution.

Conclusion

29.19 These and other issues facing AECL require decisions by the government, identification of funding sources, or agreement between AECL and the government on the appropriate course of action. These decisions need to be reflected in an approved corporate plan for AECL, a summary of which would then be tabled in Parliament.

Department of Finance

Assistant Auditor General: Ron Thompson

Principal: Jeff Greenberg

Information for Parliament and Canadians: Transparency and the government's Annual Financial Report

When the government began producing an Annual Financial Report (AFR) almost five years ago, it was responding to a need of both Parliament and the public for information to help them play a more active and effective role in guiding government decision making. Since its introduction, changes to the Annual Financial Report have been kept to a minimum in order to maintain consistency for ease of comparison from one year to the next. Yet events both domestic and international have heightened the need for improved financial reporting by governments and suggested new ways of bringing this about. We believe that it is time to revisit the Annual Financial Report to make it more useful, and we call on the Department of Finance to do so.

Background

29.20 Since the mid-1980s, this Office has been calling for the government to produce an annual financial report to help Parliament and the public play a more active and effective role in guiding government decision making. In 1993, we suggested that such a report contain not only condensed financial statements but also a section containing five indicators that would help to illustrate the state of government finances. In 1994, the government began producing such a report. For the last few years, the Annual Financial Report (AFR) has been published as part of the Minister of Finance's fall Economic and Fiscal Update.

study suggested a general set of indicators that governments might consider using to give readers a more complete and understandable picture of financial condition. These indicators were designed to report on a government's sustainability, flexibility and vulnerability. (Definitions of these terms are found in Exhibit 29.1.) The idea was to provide information on not only the state of the government's finances through credible, reliable and understandable financial statements but also on the factors that affect those public finances. This would include key indicators of the Canadian economy, as well as benchmarking Canada's performance against that of other jurisdictions in similar economic and political circumstances.

Issue

29.21 The importance and usefulness of financial reporting have taken on considerable prominence in the last few years, both domestically and internationally:

- On the domestic front, the Canadian Institute of Chartered Accountants (CICA) in 1994 initiated a research study on indicators of financial condition for the federal and provincial governments. The

- At the same time as the release of the first Annual Financial Report, the Minister of Finance began appearing before the House of Commons Finance Committee to seek its input into the Budget process. To accompany that appearance, he also began tabling a fall Economic and Fiscal Update document. Since then, that documentation has gone through a number of changes to try to make it more informative to Canadians. In fact, much of the information the CICA study suggested is

The challenge is to make information about financial condition more readily accessible and more widely used.

already currently available publicly in a variety of documents like the fall Economic and Fiscal Update. The challenge now is to make this important information more readily accessible and more widely used; in other words, to make it more *transparent*.

- The recent report of the Task Force on the Future of the Canadian Financial Services Sector declared, “Disclosure governs what information is provided. Transparency is concerned with the clarity of that information: how understandable it is to the consumer.” We share the Department’s goal of providing ordinary Canadians with simple access to useful information about the government’s financial condition, and believe the Annual Financial Report can and should play an important role in this regard.

- Others beyond Canada’s borders also see the need for better financial information. As part of its emphasis on good governance, the International Monetary Fund has been stressing the need for improved transparency in budgetary operations through its *Code of Good Practices on Fiscal Transparency*. The United Kingdom, too, has moved in this direction with its new Code of Fiscal Responsibility. As Mr. Gordon Brown, Chancellor of the Exchequer in the United Kingdom, reported to the Commonwealth

Exhibit 29.1

Indicators of Government Financial Condition

Sustainability. The degree to which a government can maintain existing programs and meet existing creditor requirements without increasing the debt burden on the economy.

Flexibility. The degree to which a government can increase its financial resources to respond to rising commitments, by either expanding its revenues or increasing its debt burden.

Vulnerability. The degree to which a government becomes dependent on, and therefore vulnerable to, sources of funding outside of its control or influence, both domestic and international.

Source: *Indicators of Government Financial Condition*,
Canadian Institute of Chartered Accountants, 1997

Meeting of Finance Ministers in Ottawa in October 1998:

Greater openness in procedures as well as in the dissemination of information will not only reduce the likelihood of market corrections by revealing potential weaknesses at an earlier stage but will generate a better understanding of the reasoning behind decisions and encourage better decisions and wider support for the policies.

All of these calls for more complete disclosure by national governments are based on the understanding that inadequate official financial information can undermine sound economic performance.

- And finally, as stated in the chapter of this Report titled Matters of Special Importance:

The recent Asian financial crisis attests to the importance of transparent, fair and complete information on the financial condition of governments. The International Monetary Fund identified lack of transparency as a contributing factor to that crisis. Understandable, timely reporting of useful information contributes to better performance, by supporting informed decision making and exposing the activities of government to the discipline of public scrutiny.

This in no way implies that the Canadian economy or government finances are comparable with the Asian economies. Nevertheless, this concern for transparency has sparked the current Minister of Finance to call for better and more complete reporting by financial institutions internationally. His argument is simply that better and more timely information would reveal potential weaknesses earlier and lead to corrections before crises developed.

Conclusion

29.22 The government's decision to produce an Annual Financial Report with a condensed set of financial statements accompanied by selected indicators was a major step forward in communicating the government's financial condition to parliamentarians and Canadians generally. But readership of this important accountability document has dropped in recent years, even though the need for the

type of information it conveys has been heightened. In our view, it is time for the Department of Finance to revisit the form and content of the Annual Financial Report to make it a more useful document. In doing so, the Department might consider ways of linking the document more clearly to the Minister's fall Economic and Fiscal Update, and perhaps streamlining the size and shape of the report to facilitate its access and use by interested Canadians.

**It is time for the
Department of Finance
to revisit the form and
content of the Annual
Financial Report to
make it a more useful
document.**

Industry Canada and Natural Resources Canada

Assistant Auditor General: Richard Flageole

Principal: Peter Simeoni

Concerns about poor control over computers loaned to employees for home use

Many government departments and agencies lend their employees spare computer equipment for official use at home. In our view, this practice is not being managed properly in the two departments we audited. We are also concerned that this weak control may affect the federal government's contribution to the Computers for Schools program.

Background

29.23 Many departments and agencies allow employees to take home computer equipment for work-related reasons once it is no longer needed at the office. This equipment becomes available for home use when it has been replaced by newer hardware at the office and is not needed to meet any anticipated departmental requirements.

29.24 In the case of Industry Canada, although records are not up-to-date, we estimate that as many as 1,000 of the Department's 4,900 employees have taken computer equipment home; at least 800 employees of Natural Resources Canada have done the same. Although some of these computers are used for approved teleworking arrangements, the vast majority have been provided as a second computer at home, in addition to one at the office, to enhance productivity. While we have not looked at the situation in every federal department and agency, there are indications that the loan of computers is widespread throughout the government.

29.25 Government policy specifies that when these computers are no longer needed to do work at home, they are supposed to be returned to the department and sent to the Computers for Schools program after being declared surplus. Computers for Schools, a partnership

formed in 1993 by Industry Canada and Telephone Pioneers, is a program administered by Industry Canada and delivered in co-operation with provincial governments, businesses and volunteer organizations. Computer equipment donated by the private and public sector is collected, refurbished and distributed to schools and libraries across the country for free.

29.26 The inspection and repair of donated equipment take place in regional workshops operated by volunteers from the Telephone Pioneers, a volunteer group of employees and retirees of the telecommunications industry, and other program partners. Support from these companies includes space for warehousing and repair operations and, along with other private sector partners, they assist in many other ways such as shipping equipment to school boards.

29.27 The program challenge is to place 250,000 used and refurbished computers in schools and libraries across the country by the end of March 2001. According to the program's figures, a total of 78,000 computers since 1996 have been donated by the federal and provincial governments and the private sector and shipped to schools as of August 1998. Program managers advise that Industry Canada is the fifth largest donor of computers among federal departments. The program expects to ship an increasing

number of computers to schools in the next two years in order to achieve its target.

29.28 An important effect of the program, beyond the obvious benefits of increasing the ratio of computers to students in our schools, is that equipment that no longer has value for governments and businesses gains a second life in a classroom.

Issues

29.29 We focussed our audit on whether the federal government had adequate policies and practices for controlling the loan of computer equipment to employees. We also considered whether any weaknesses we found in policies and practices affected the government's contribution to the Computers for Schools program.

29.30 We examined the relevant policies set by the Treasury Board Secretariat on materiel management as well as the computer equipment management policies and practices of two departments: Industry Canada and Natural Resources Canada.

Policy framework

29.31 **Government-wide policies for loan of equipment.** The Treasury Board's *Materiel Management Policy* sets out the management framework for all kinds of government-owned equipment, including computer systems. Under the policy, equipment can be taken home for work-related duties only. The policy states that the materiel is always Crown property; when it is no longer being used for work-related duties, managers are responsible for its recovery.

29.32 Once recovered, equipment that is no longer needed or is not cost-effective to repair can be declared surplus. Normally, surplus materiel is auctioned off. However, the policy requires departments to donate surplus computer

equipment to the Computers for Schools program.

29.33 **Departmental policies for loan of equipment.** We looked at the policies of two departments: Industry Canada and Natural Resources Canada. Both departments advised us that by allowing employees to take home spare computers, managers have found an economical way to increase productivity.

29.34 According to Industry Canada's policy, computer equipment no longer required by a responsibility centre can be borrowed for specific work-related activities at home. The Department also lends equipment to help employees improve their computer proficiency. Employees must have the loan approved by the designated managers who are responsible for ensuring that loans of equipment are justified. All microcomputer equipment in employees' homes is supposed to be recorded in the department's central asset management information system.

29.35 Natural Resources Canada does not have formal departmental policy or procedures for the loan of computer equipment to employees, and there is no corporate inventory. The Department is organized into five sectors, with each one managing its own assets. Some sectors have a policy on loaning microcomputers, others do not. Where policies exist, they are similar to those of Industry Canada in that employees are allowed to take computer equipment home for work-related or training purposes. One sector has a list of borrowed equipment; the other four expect individual managers to keep track of computer loans.

29.36 In our view, Industry Canada has clear and simple policies for managing this equipment across the Department, while Natural Resources Canada does not. Natural Resources Canada is in the process of developing an asset management policy that will include microcomputers.

Departments need to strengthen their control practices for computer equipment on loan to employees.

Weaknesses in departmental practices may affect the federal contribution to the Computers for Schools program.

Weak departmental control practices

29.37 Approval of loans. We examined whether the loan of computer equipment was authorized and justified. In Industry Canada, we found many examples where loans had been approved by unauthorized individuals. In most cases we examined, the reason given for the loan was no more specific than it was "work-related"; in some cases, no reason at all was given.

29.38 At Natural Resources Canada, individual managers are expected to develop their own controls for computers; there is no departmental system. We looked at the practices of two managers, and found that, while their procedures were different, loans were approved by the appropriate person. Neither manager required that the reason for the loan be explained on file.

29.39 Inadequate records. We are also concerned that both departments have inadequate records of computer equipment on loan. Our review of Industry Canada's records indicates that they are out-of-date. We found that the Department does not have adequate information on how much equipment is loaned out to employees and how much has been returned. The Department was implementing a new asset management system, planning a physical count of all equipment and piloting tighter control procedures at the time of our audit.

29.40 Some sectors within Natural Resources Canada were able to provide us with lists of loaned equipment; others have no single list but have loan approvals on file. However, without a reasonably current inventory of all computer equipment against which to compare, we were unable to determine whether these lists, together with the approvals on file, provided a complete record of equipment on loan. The Department was also implementing a new asset management system at the time of our audit.

29.41 As a result, we are concerned that this may lead to situations where employees:

- are borrowing equipment for other than work-related reasons;
- have more than one computer from the department at home;
- do not return equipment when leaving or transferring within the public service; and
- return equipment, but it is not recorded in the inventory system.

29.42 Related issues. Another issue that departments need to consider in managing computers on loan to employees is Internet access. First, both departments allow employees to access the Internet from home through departmental networks using either loaned computers or their own. We found that Industry Canada has an Internet use policy and reviews the Internet activity of employees for inappropriate use. However, Natural Resources Canada does not actively monitor Internet use either from the office or home. In our view, it is important to review the risk of not monitoring Internet activity for inappropriate use. Natural Resources Canada is in the process of developing an Internet policy on usage, monitoring and reporting.

Impact on Computers for Schools program

29.43 The weaknesses we found in departmental practices may affect the federal contribution to the Computers for Schools program. In our view, managers are not encouraged to recognize the considerable value that computer equipment still has after it is surplus to government needs. While most kinds of equipment have outlived their usefulness by the time they are declared surplus, the Computers for Schools program breathes new life into computer equipment. Even older computers have value because they can be used by schools for applications

requiring less computing power, such as word processing, thereby freeing up more powerful equipment for other uses. But because these computers are treated like all other materiel, managers are encouraged to find increasingly marginal uses for them until they have no use at all.

29.44 Weak control over microcomputers may have resulted in fewer useful computers being donated by the federal government to the program. We found that the federal government has donated almost 80,000 computers in total to date. However, one third were found to be missing key components such as the processor, memory or the hard drive. The program was able to salvage many of these computers, but the rest were of no use. In the case of the two departments we audited, we were unable to determine why components were removed from some of the computers donated to the program. Departmental officials explained that some components were probably retained for the purposes of repairing similar computers, but they do not keep records. In our view, and in the view of the departments we audited, the removal of computer components should be for valid reasons.

Conclusion

29.45 We believe that there is a need to establish consistency and minimum control requirements within and across government departments and agencies for

the loan of computer equipment to employees. It is important that:

- computer equipment be loaned to employees only for truly work-related reasons;
- responsible managers always approve the long-term removal of government property from departmental premises;
- equipment not be loaned to employees indefinitely;
- equipment be returned when it is no longer being used for work-related activities;
- departments and agencies consider setting recall dates coinciding with the nature of the work being done at home; and
- control over computers at homes of employees be improved and the inventory records kept up-to-date.

29.46 Finally, loaning computer equipment to employees indefinitely without a clear work-related reason could encourage them to treat government property as their own. Controls should be established to strike a balance between the cost of control and the risk of misuse, while also considering the benefits of making these assets available to employees for work at home and giving them a second life in schools.

Public Works and Government Services Canada

Assistant Auditor General: Shahid Minto

Director: Joe Martire

There is an urgent need for an updated long-term comprehensive plan to restore and renovate the Parliamentary Precinct and for a non-partisan advisory body to assist Parliament and the government by providing advice on the plan and the priorities of work

Canada's Parliament buildings are undergoing an extensive restoration and renovation program. It is widely acknowledged that the buildings are in need of repair and restoration.

Roles, responsibility and accountability for actual and planned expenditures totalling hundreds of millions of dollars continue to be complex and unclear. No one organization has overall responsibility for the Parliamentary Precinct. The Senate and the House of Commons should reconsider our 1992 recommendation to establish a Parliament Buildings Council.

Despite assurances to the Treasury Board over the last three years that it would submit a revised long-term plan, Public Works and Government Services Canada (Public Works) has not yet sought approval of an updated comprehensive long-term plan for the Parliamentary Precinct. Because future projects are inextricably linked, there is a pressing need for an approved long-term strategic plan that articulates the program's objectives, scope and cost.

Background

29.47 Exhibit 29.2 defines the Parliamentary Precinct and Exhibit 29.3 summarizes the respective roles and responsibilities of key organizations involved in the Precinct.

29.48 In our December 1992 Report to the Senate and the House of Commons on Matters of Joint Interest, we made several observations and recommendations aimed at assisting Parliament and the government to make decisions about the maintenance and improvement of the

Parliamentary Precinct



Parliamentary Precinct buildings. Specifically, the report noted that:

- roles and responsibilities for the Parliamentary Precinct were complex and needed to be clarified and rationalized;
- progress on making and implementing plans for renovations and capital improvements for the Parliamentary Precinct had been slow; and
- better reporting of costs was needed.

29.49 We recommended the establishment of a small, voluntary, non-partisan advisory body, a Parliament Buildings Council, to provide outside advice on priorities of work required on Parliament Hill and to improve the quality of information available. Our detailed recommendations concerning the Council's objectives, mode of operations, organization and membership are presented on pages 49 and 50 of the Annex to the 1992 Report to the Senate

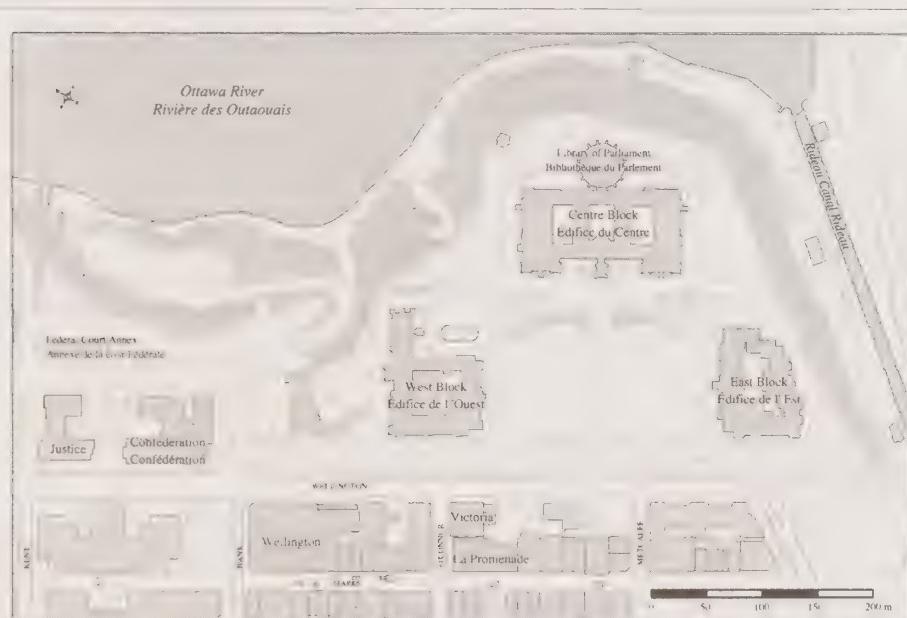


Exhibit 29.2

Defining the Parliamentary Precinct

Historically, the Parliamentary Precinct has generally been defined on the basis of use rather than geography. Public Works and Government Services Canada defines the Precinct as all Crown-owned buildings occupied by the House of Commons, the Senate and the Library of Parliament. The Crown-owned Precinct portfolio consists of:

- the Centre, East and West Blocks;
- the Library of Parliament;
- the Peace Tower; and
- the Confederation, Wellington, Victoria and La Promenade buildings.

The Justice Building was recently added to the portfolio, following the relocation of the Department of Justice occupants to the East Memorial Building. The Federal Court Annex Building (the white wood structure located to the north of the Justice Building) was also recently added to the portfolio. The grounds associated with these buildings are also included in the Precinct.

Public Work's leased space for the Precinct comprises:

- five leases to support the House of Commons, consisting of 12,620 square metres and costing about \$2.2 million per year; and
- two leases to support the Senate, consisting of 2,716 square metres and costing about \$0.5 million per year.

Source: Public Works and Government Services Canada

and the House of Commons on Matters of Joint Interest.

29.50 According to Public Works documents, the Department spent about \$183.5 million on asset and accommodation improvements during the period 1992–93 to 1997–98. It also spent an average of about \$25.6 million annually, including payments in lieu of taxes, to operate and maintain the Parliamentary Precinct.

29.51 Major projects completed since 1992 include conservation of the Peace Tower, rehabilitation of the 1910 wing of the East Block, repair of the south façade of the Centre Block, masonry repairs throughout the Precinct, and construction of the Centre Block two-storey underground utility and storage facility.

Issues

29.52 Updating the long-term plan. The need for an approved comprehensive plan to restore and renovate the buildings and grounds of the Parliamentary Precinct and to address Parliament's long-term accommodation requirements has long

been recognized. The chronology of key events leading to the development in 1992 of a long-term construction program (LTCP) is outlined in Exhibit 29.4.

29.53 According to Public Works officials, the 1992 long-term construction program was developed with early input of the accommodation and functional requirements of the House of Commons, the Senate and the Library of Parliament. Furthermore, the physical condition of the assets within the Precinct was much worse than preliminary investigations indicated. In addition, accommodation and functional requirements have changed over this period. Security requirements are being re-considered and information technology requirements are adding increasing pressures.

29.54 In June 1995, Public Works informed the Treasury Board that it would submit an updated long-term plan at an appropriate time. In March 1997, Public Works informed Treasury Board that it would be submitting, later that year, a revised LTCP identifying overall program cash flows and funding requirements to fiscal year 2010–11. The plan would also

Exhibit 29.3

Roles and Responsibilities of Key Organizations Involved in the Precinct

- The Minister of Public Works and Government Services is the official custodian of the buildings and is charged with responsibility for their care and upkeep, specified in law. However, there is another relevant constitutional principle – that the two Houses are each responsible for their internal affairs. The challenge, therefore, is to balance the Minister's legislative authority with Parliament's constitutional and legislative authority for its own affairs.
- In the House of Commons, accommodation matters are the ultimate responsibility of the Board of Internal Economy. The Board is chaired by the Speaker of the House of Commons and includes representation from all official parties.
- At the Senate, responsibility for accommodation matters rests ultimately with the full Senate. The Committee on Internal Economy is usually delegated to examine and recommend action on accommodation matters.
- Other departments and agencies add to the complexity of the situation:
 - The Treasury Board Secretariat is responsible for providing a policy framework for management of all real property and advises the Treasury Board on its decisions related to long-term planning and funding for the Precinct.
 - The National Capital Commission has responsibility for outdoor visitor programming, services and events, and for design and planning approvals within the Precinct. It is also responsible for grounds management.
 - Parks Canada, through the Federal Heritage Building Review Office, is involved in heritage aspects of the decisions to improve the buildings and land on the Precinct.

In addition, the RCMP, the City of Ottawa, the Regional Municipality of Ottawa–Carleton and other groups may be involved in addressing specific issues.

Source: Public Works and Government Services Canada

include additional funding requirements for furniture, fixtures and equipment for all future projects. A preliminary profile of the revised LTCP noted that the cost of major capital projects (over \$1 million) would total approximately \$750 million from 1992–93 to 2010–11.

29.55 On 23 September 1998, the Minister of Public Works and Government Services reported that “*the currently forecast cost to complete approved restoration and renovation projects is \$423,324,102.*” The report, however, was not intended to provide the estimated costs to fully restore and renovate the Parliamentary Precinct and to fully address the accommodation, security and information technology needs of parliamentarians, staff, visitors and the media. According to Public Works working documentation, the cost both of approved projects and of those yet to be approved could total about \$1.4 billion over the period 1992–93 to 2012–13.

29.56 Requirements of the plan. Public Works policies and good building management practices require that asset management plans be prepared and kept up-to-date for each asset. The plans should identify the life cycle costs of operating, maintaining and, in some cases, preserving the asset. We noted that these

plans have not been fully prepared for all Parliamentary Precinct buildings. Public Works officials informed us that there are additional reports on specific aspects of each building and that this information needs to be consolidated into the updated long-term plan.

29.57 Because future projects are interrelated, there is a pressing need for an updated and comprehensive long-term plan for the Parliamentary Precinct. The approved plan would facilitate a well-ordered, logical development of the Parliamentary Precinct. For example, although Public Works has secured Treasury Board approval to renovate the West Block, the budget did not account for the potential changes to clients’ requirements for committee rooms that will be decommissioned during the West Block renovations. According to Public Works officials, a decision is also needed, for security reasons, on the location and design of a loading dock for the West Block before the building can be occupied. In 1996, Public Works acquired the United States Embassy building, which may be added to the Parliamentary Precinct. However, the building’s future use has not yet been determined.

29.58 The plan also needs to address issues such as space standards for members of Parliament, ministers,

Because future projects are interrelated, there is a pressing need for an updated comprehensive long-term plan for the Parliamentary Precinct.

The Abbott Commission report of 1976 made a number of recommendations regarding the amount and type of accommodation and facilities that Parliament required to operate effectively in the future.

A consultants report in 1987, sponsored jointly by the National Capital Commission and Public Works, included recommendations that provided a preliminary basis for an accommodation plan in the Parliamentary Precinct, as well as both urban design guidelines and a demonstration plan for long-term development. The principles, urban design guidelines, and demonstration plan/concept of the Demonstration Plan were subsequently approved by the National Capital Commission.

In September 1988, Cabinet approved a Real Property Capital Investment Strategy for the National Capital Region including a Parliamentary Precinct construction program. Cabinet directed the Minister of Public Works, in consultation with government leaders in the House of Commons and Senate, to develop a government position on the Precinct development plan for approval by the Treasury Board and Cabinet.

In September 1992, the Treasury Board approved in principle Public Works’ long-term construction program for the Parliamentary Precinct. Public Works estimated the program’s total cost at \$483 million, comprised of \$265 million to address health and safety issues and ensure the essential operations of Parliament and \$218 million to address all other accommodation needs. Due to fiscal constraints, \$265 million was approved over an 11-year period.

Exhibit 29.4

Key Events Leading to the Development of a Long-Term Construction Program for the Parliamentary Precinct

Source: Public Works and Government Services Canada

Without an updated long-term plan, resources cannot be allocated and managed in a cost-effective manner.

senators, Parliamentary Precinct staff, and the media; their proximity to the Hill; and other related issues such as security, parking and visitor services. Without an updated long-term plan, resources cannot be allocated and managed in a cost-effective manner. The approved plan would establish a baseline for measuring and assessing the program's progress.

29.59 Roles and responsibilities. We noted that roles and responsibilities continue to be complex and unclear and we are concerned that our 1992 recommendation to establish a Parliament Buildings Council has not yet been implemented.

29.60 Sound project management principles require that roles and responsibilities of key participants be clearly defined and documented, normally in a memorandum of understanding or a project charter. We noted that these formal mechanisms had not been in place for projects completed to date. We were informed that although there is extensive

consultation regarding project requirements, the House of Commons and the Senate generally do not formally "sign off" their statements of requirements.

29.61 Public Works officials also informed us that it is complex to co-ordinate and reach agreement on common requirements for the House of Commons, the Library of Parliament, the Senate and their staffs. They believe that potential cost savings may be realized through better co-ordination of requirements and sharing of facilities and systems. A first step has been taken with the Parliamentary Precinct Information Technology Program Charter signed in December 1997 by Public Works, the Senate, Library of Parliament and the House of Commons. Public Works officials believe that further savings may be achievable through a co-ordinated overall study of such things as the House of Commons and Senate committee room requirements. Exhibit 29.5 illustrates a case of the difficulty in co-ordinating and reaching agreement on requirements.

Exhibit 29.5

Case Study – Cafeteria in the 1910 Wing of the East Block

The 1990 statement of user requirements identified the need for a cafeteria in the 1910 Wing of the East Block.

During project planning, officials of the House of Commons and the Senate took part in consultations with officials of Public Works.

Construction of the cafeteria commenced in December 1995.

At its meeting of 11 June 1996, the Board of Internal Economy of the House of Commons questioned the inclusion of a cafeteria because it was closing other cafeterias on the Hill and indicated its intention to raise the issue with both the Minister and the Senate.

In November 1996, the Senate informed Public Works that the original requirement for a cafeteria had changed, and that the space was to be reallocated as a committee room.

In May 1997, a consultant engaged by Public Works reported that the existing cafeteria could be transformed into a limited-use conference room but the space allocation did not meet committee room requirements.

According to Public Works officials, except for the deletion of minor cooking equipment, it was determined that it would not be cost-effective to implement the Senate's request to reallocate the space from a cafeteria to a committee room. Therefore, despite the requests from the Senate, Public Works proceeded with the original project.

The cafeteria was completed in July 1997 at an estimated construction cost of \$612,000. It is being used for purposes other than intended.

Conclusion

29.62 Work on the Parliamentary Precinct is considered necessary to preserve and maintain one of Canada's most treasured national symbols and to take into account Parliament's accommodation, security and information technology requirements into the 21st century. In our view, current arrangements and management practices need strengthening if these important national heritage assets are to be managed and preserved with due regard to long-term economy and efficiency. For the restoration and renovation program to be a success, there must be general consensus about the program's objectives, scope and cost among all the key stakeholders.

29.63 This is an opportune time to update the long-term plan to restore and renovate the Parliamentary Precinct. The comprehensive long-term plan needs to include guiding principles to address the accommodation, security and information technology requirements of parliamentarians, staff, visitors and the media. We reaffirm our view that a non-partisan co-ordinating Council is necessary to review the plan for the development of the Parliamentary Precinct. The appointments to the Council should be made in a manner that is transparent, equitable, and enhances the independence of the body. For example, it could be composed of eminent Canadians, with input from all parties. It is important that such a council be established sooner

rather than later and that it review the plan before it is submitted to the Treasury Board.

29.64 We plan to monitor the work on the Parliamentary Precinct and report to Parliament, as appropriate.

Public Works and Government Services

Canada response: The Parliament Buildings are a unique heritage resource, as well as an important national symbol of Canada. These buildings are also the centre of parliamentary operations and a venue for celebration.

A long-term capital plan for the Parliamentary Precinct has been in place since 1992. The plan included many projects now completed such as the conservation of the Peace Tower, the renovation of the 1910 Wing of the East Block, the construction of the Centre Block Underground Services facility, urgent masonry repairs, etc. The current 1992 long-term plan covers the period until 2003–2004.

Public Works and Government Services Canada is currently developing a further plan for the period beyond 2004 until 2007. The overall plan will be updated regularly in accordance with a long-term planning framework that will provide a forum for stakeholders (Senate, Library of Parliament, House of Commons, National Capital Commission, Federal Heritage Building Review Office, and Treasury Board) to provide their input into the development plans for the Parliamentary Precinct.

For the restoration and renovation program to be a success, there must be general consensus about the program's objectives, scope and cost among all the key stakeholders.

Revenue Canada

Assistant Auditor General: Shahid Minto

Principal: Barry Elkin

Fairness in the Canadian income tax system

Fairness in treating people and applying the law is the cornerstone of the administration of the Canadian income tax system. The principle of fairness is enshrined in Revenue Canada values and objectives. One of these objectives is to ensure the fair and timely assessment, collection and, where appropriate, refund of all taxes, duties and other relevant charges and levies.

During the course of our work, we came across two situations that raise concerns about the fairness of the Canadian income tax system. Although these two situations do not involve significant tax leakage, they do affect certain individuals in a significant manner. We believe that over time they have the potential to erode the confidence of taxpayers in the fairness of the Canadian income tax system.

Deficiency in the matching program for personal income tax returns

Taxpayers who underestimate the amount of income tax deducted at source on their income tax returns end up paying more than their fair share of income tax. This is because Revenue Canada's matching program for personal income tax returns is not designed to detect this type of taxpayer error.

Background

29.65 Revenue Canada has a processing program that compares information reported by taxpayers on their personal income tax returns with information obtained from third parties. The program is designed to identify and correct situations where taxpayers have overstated the amount of tax deducted at source on their income tax returns.

29.66 To understand the issue, we examined a sample of 1996 income tax returns that included Old Age Security (OAS) pension income on which tax had been deducted. In about four percent of the cases reviewed, we found that taxpayers had understated the taxes

deducted at source on their OAS pension income on their income tax returns. The average amount of unreported tax deducted at source was \$1,865. In all these cases, Revenue Canada's processing program did not detect or correct these taxpayer errors and the taxpayers ended up paying more than their fair share of taxes.

Issue

29.67 Revenue Canada's processing program is not designed or set up to identify situations where taxpayers have understated the amount of tax deducted at source on their income tax returns. Consequently, taxpayers that have understated the amount of their tax deducted at source will end up overpaying their personal income taxes.

Conclusion

29.68 Taxpayers may be paying more than their fair share of income tax because of a deficiency in Revenue Canada's processing program for personal income tax returns. We believe there is a need for Revenue Canada to correct this deficiency. This would increase the fairness and equity of the Canadian tax system.

Department's response: Revenue Canada places a very high priority on the fairness

of the Canadian taxation system. The Department is committed to seeing that Canadians pay their fair share of income tax, no more and no less. Revenue Canada's "Fairness Initiative", which was launched by the Minister in March of 1998 and involves a wide range of consultations with action plans, is one method of ensuring that we fulfil this commitment.

For the specific issue cited, 95 percent of Old Age Security (OAS) recipients do not have tax deducted at source. For the remaining five percent of cases, where tax is deducted, the Department has procedures in place to detect situations when a taxpayer has neglected to report both OAS income and taxes deducted. We acknowledge that a small percentage of understated tax deductions currently go undetected. The Department will place a priority on finding a solution to this problem through better training of volunteers (who assist seniors in preparing their income tax returns), general education, and system improvements. The Department is confident that these actions, in conjunction with our continual improvement processes, will address this deficiency.

Transfer of pension funds outside Canada without withholding taxes

Public service employees' pension funds can be transferred out of Canada, on a tax-free basis, through a reciprocal transfer agreement between the federal government and a foreign employer. This treats certain taxpayers more favourably than other taxpayers that must pay tax when transferring their pension funds outside Canada.

Background

29.69 Public Service employees who accept a permanent position with a particular foreign employer may transfer their pension credits through a reciprocal transfer agreement to the new employee's

pension plan, if it is registered for purposes of the *Income Tax Act*. The funds can be transferred on a tax-free basis.

29.70 Reciprocal transfer agreements are agreements between the Government of Canada and other employers whereby employees may have their pension plan contributions, plus the matching employer contributions and interest in respect of immediately prior service with one employer, transferred either from the federal government to another employer or vice versa. The purpose of these agreements is to facilitate the mobility of persons between the Government of Canada and other employers.

29.71 In 1991, Pension Reform was introduced and income tax rules for registered pension plans were changed. All pension plans were required to comply with the new rules in order to maintain their registered status.

29.72 In 1995, the Treasury Board Secretariat notified international government-sponsored organizations that it would no longer recognize the reciprocal transfer agreement if the organizations' pension plans were not registered with Revenue Canada. As many organizations did not wish to amend their plans, the Secretariat considered their agreements as no longer valid and notified the organizations of its decision. However, as a result of a reciprocal agreement with one of the organizations, we noted that pension funds totalling \$500,000 were transferred out of Canada by public servants over three years without the normal withholding tax. The Secretariat advised us that it kept the agreement active because it had received information suggesting the foreign plan was still registered with Revenue Canada.

Issue

29.73 Our concern is that funds in a Canadian registered pension plan can be transferred out of Canada on a tax-free basis to a foreign pension that is registered for purposes of the *Income Tax Act*.

Canada and the provinces absorbed a reduction in their tax revenues when contributions were made to the Canadian plan. However, they will not necessarily receive any tax when the pension benefits earned in Canada are withdrawn from the foreign-based plan.

29.74 Pension benefits paid to a non-resident by a Canadian registered pension plan are subject to Canadian withholding tax. However, the current agreement makes it possible to transfer funds from a registered Canadian pension plan to a foreign pension plan and avoid Canadian withholding tax. We are concerned that the registration of foreign plans may be used in tax schemes designed to transfer pension funds out of the country on a tax-free basis.

Conclusion

29.75 Certain taxpayers have been allowed to transfer their pension funds out of Canada on a tax-free basis. As a result, these taxpayers are treated more favourably than those who must pay tax when transferring their pension funds out of Canada. This is contrary to the fairness principles of our self-assessment tax

system. It is not clear if Parliament intended this to happen.

Department's response: *The objective of reciprocal transfer agreements is to facilitate the movement of employees' service from one registered pension plan to another. Such agreements are common in both private and public sector registered pension plans.*

The plan in question is one of five foreign plans that were registered prior to the 1992 pension reform. In 1992, new rules restricting the registration of foreign plans were introduced as part of pension reform. These new rules called into question the registered status of these plans. As it was not until June 1996 that regulations were passed to deal with Canadians participating in unregistered foreign plans, Revenue Canada waited for the passage of the 1996 regulations before examining the registered status of these plans.

At this time, Revenue Canada is taking steps to ensure that the rules are applied uniformly to all foreign plans. If the plan is to maintain its registered status under the new rules, one of the registration requirements is that funds must be held in Canada.

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APPENDIX A

AUDITOR GENERAL ACT

R.S.C., c. A-17

An Act respecting the Office of the Auditor General of Canada and
sustainable development monitoring and reporting
1995, c. 43, s.1.

SHORT TITLE

Short title 1. This Act may be cited as the *Auditor General Act*. 1976-77, c. 34, s.1.

INTERPRETATION

Definitions	2. In this Act,
"appropriate Minister"	"appropriate Minister" has the meaning assigned by section 2 of the <i>Financial Administration Act</i> ;
"Auditor General"	"Auditor General" means the Auditor General of Canada appointed pursuant to subsection 3(1);
"category I department"	"category I department" means
	(a) any department named in Schedule I to the <i>Financial Administration Act</i> ,
	(b) any department in respect of which a direction has been made under subsection 24(3), and
	(c) any department, as defined in the <i>Financial Administration Act</i> , set out in the schedule;
"Commissioner"	"Commissioner" means the Commissioner of the Environment and Sustainable Development appointed under subsection 15.1(1);
"Crown corporation"	"Crown corporation" has the meaning assigned to that expression by section 83 of the <i>Financial Administration Act</i> ;
"department"	"department" has the meaning assigned to that term by section 2 of the <i>Financial Administration Act</i> ;
"registrar"	"registrar" means the Bank of Canada and a registrar appointed under Part IV of the <i>Financial Administration Act</i> ;
"sustainable development"	"sustainable development" means development that meets the needs of the present without compromising the ability of future generations to meet their own needs;
"sustainable development strategy"	"sustainable development strategy", with respect to a category I department, means the department's objectives, and plans of action, to further sustainable development. 1976-77, c. 34, s. 2; 1984, c. 31, s. 14; 1995, c. 43, s. 2.

AUDITOR GENERAL OF CANADA

Appointment and tenure of office 3. (1) The Governor in Council shall, by commission under the Great Seal, appoint a qualified auditor to be the officer called the Auditor General of Canada to hold office during good behaviour for a term of ten years, but the Auditor General may be removed by the Governor in Council on address of the Senate and House of Commons.

Idem	(2) Notwithstanding subsection (1), the Auditor General ceases to hold office on attaining the age of sixty-five years.
Re-appointment	(3) Once having served as the Auditor General, a person is not eligible for re-appointment to that office.
Vacancy	(4) In the event of the absence or incapacity of the Auditor General or if the office of Auditor General is vacant, the Governor in Council may appoint a person temporarily to perform the duties of Auditor General. 1976-77, c. 34, s. 3.
Salary	4. (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.
Pension benefits	(2) The provisions of the <i>Public Service Superannuation Act</i> , other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the Public Service may, by notice in writing given to the President of the Treasury Board not more than sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the <i>Diplomatic Service (Special) Superannuation Act</i> in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the <i>Public Service Superannuation Act</i> do not apply to him. 1976-77, c. 34, s. 4; 1980-81-82-83, c. 50, s. 23, c. 55, s. 1.

DUTIES

Examination	5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act. 1976-77, c. 34, s. 5.
Idem	6. The Auditor General shall examine the several financial statements required by section 64 of the <i>Financial Administration Act</i> to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have. 1976-77, c. 34, s. 6; 1980-81-82-83, c. 170, s. 25.
Annual and additional reports to the House of Commons	7. (1) The Auditor General shall report annually to the House of Commons and may make, in addition to any special report made under subsection 8(1) or 19(2) and the Commissioner's report under subsection 23(2), not more than three additional reports in any year to the House of Commons <ul style="list-style-type: none"> (a) on the work of his office; and, (b) on whether, in carrying on the work of his office, he received all the information and explanations he required.
Idem	(2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that <ul style="list-style-type: none"> (a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

- (b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;
- (c) money has been expended other than for purposes for which it was appropriated by Parliament;
- (d) money has been expended without due regard to economy or efficiency;
- (e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or
- (f) money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

Submission of annual report to Speaker and tabling in the House of Commons

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before December 31 in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it.

Notice of additional reports to Speaker and tabling in the House of Commons

(4) Where the Auditor General proposes to make an additional report under subsection (1), the Auditor General shall send written notice to the Speaker of the House of Commons of the subject-matter of the proposed report.

Submission of additional reports to Speaker and tabling in the House of Commons

(5) Each additional report of the Auditor General to the House of Commons made under subsection (1) shall be submitted to the House of Commons on the expiration of thirty days after the notice is sent pursuant to subsection (4) or any longer period that is specified in the notice and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it. 1976-77, c. 34, s. 7; 1994, c. 32, s. 1 and 2; 1995, c. 43, s. 3.

Special report to the House of Commons

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in the opinion of the Auditor General, should not be deferred until the presentation of the next report under subsection 7(1).

Submission of reports to Speaker and tabling in the House of Commons

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 19(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting. 1976-77, c. 34, s. 8; 1994, c. 32, s. 3.

Idem

9. The Auditor General shall

- (a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and
- (b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act*,

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities. 1976-77, c. 34, s. 9.

**Improper retention
of public money**

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board. 1976-77, c. 34, s.10.

Inquiry and report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought. 1976-77, c. 34, s. 11.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the public service of Canada of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board. 1976-77, c. 34, s. 12.

ACCESS TO INFORMATION**Access to
information**

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the public service of Canada such information, reports and explanations as he deems necessary for that purpose.

**Stationing of
officers in
departments**

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*. 1976-77, c. 34, s.13.

**Reliance on audit
reports of Crown
corporations**

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

**Auditor General
may request
information**

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

**Direction of the
Governor in Council**

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada. 1976-77, c. 34, s. 14.

STAFF OF THE AUDITOR GENERAL

Officers, etc.

15. (1) Such officers and employees as are necessary to enable the Auditor General to perform his duties shall be appointed in accordance with the *Public Service Employment Act*.

Contract for professional services

(2) Subject to any other Act of Parliament or regulations made thereunder, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his office in appropriation Acts, contract for professional services.

Delegation to Auditor General

(3) The Auditor General may exercise and perform, in such manner and subject to such terms and conditions as the Public Service Commission directs, the powers, duties and functions of the Public Service Commission under the *Public Service Employment Act*, other than the powers, duties and functions of the Commission in relation to appeals under section 21 of that Act and inquiries under section 34 of that Act.

Suspension

(4) The Auditor General may suspend from the performance of his duty any person employed in his office. 1976-77, c. 34, s. 15; 1992, c. 54, s. 79.

Appointment of Commissioner

15.1 (1) The Auditor General shall, in accordance with the *Public Service Employment Act*, appoint a senior officer to be called the Commissioner of the Environment and Sustainable Development who shall report directly to the Auditor General.

Commissioner's duties

(2) The Commissioner shall assist the Auditor General in performing the duties of the Auditor General set out in this Act that relate to the environment and sustainable development. 1995, c. 43, s. 4.

Responsibility for personnel management

16. In respect of persons employed in his office, the Auditor General is authorized to exercise the powers and perform the duties and functions of the Treasury Board under the *Financial Administration Act* that relate to personnel management including the determination of terms and conditions of employment and the responsibility for employer and employee relations, within the meaning of paragraph 7(1)(e) and sections 11 to 13 of that Act. 1976-77, c. 34, s.16.

Classification standards

17. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office. 1976-77, c. 34, s. 18.

Delegation

18. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 64 of the *Financial Administration Act* and his reports to the House of Commons under this Act, and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General. 1976-77, c. 34, s. 19.

ESTIMATES

Estimates

19. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.

Special report

(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office. 1976-77, c. 34, s. 20.

Appropriation allotments

20. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General. 1976-77, c. 34, s. 21.

AUDIT OF THE OFFICE OF THE AUDITOR GENERAL

Audit of the office of the Auditor General

21. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and disbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

Submission of reports and tabling

(2) Each report referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting. 1976-77, c. 34, s. 22.

SUSTAINABLE DEVELOPMENT

Purpose

21.1 The purpose of the Commissioner is to provide sustainable development monitoring and reporting on the progress of category I departments towards sustainable development, which is a continually evolving concept based on the integration of social, economic and environmental concerns, and which may be achieved by, among other things,

- (a) the integration of the environment and the economy;
- (b) protecting the health of Canadians;
- (c) protecting ecosystems;
- (d) meeting international obligations;
- (e) promoting equity;
- (f) an integrated approach to planning and making decisions that takes into account the environmental and natural resource costs of different economic options and the economic costs of different environmental and natural resource options;
- (g) preventing pollution; and
- (h) respect for nature and the needs of future generations. 1995, c. 43, s. 5.

Petitions received

22. (1) Where the Auditor General receives a petition in writing from a resident of Canada about an environmental matter in the context of sustainable development that is the responsibility of a category I department, the Auditor General shall make a record of the petition and forward the petition within fifteen days after the day on which it is received to the appropriate Minister for the department.

Acknowledgement to be sent

(2) Within fifteen days after the day on which the Minister receives the petition from the Auditor General, the Minister shall send to the person who made the petition an acknowledgement of receipt of the petition and shall send a copy of the acknowledgement to the Auditor General.

Minister to respond	(3) The Minister shall consider the petition and send to the person who made it a reply that responds to it, and shall send a copy of the reply to the Auditor General, within
	(a) one hundred and twenty days after the day on which the Minister receives the petition from the Auditor General; or
	(b) any longer time, where the Minister personally, within those one hundred and twenty days, notifies the person who made the petition that it is not possible to reply within those one hundred and twenty days and sends a copy of that notification to the Auditor General.
Multiple petitioners	(4) Where the petition is from more than one person, it is sufficient for the Minister to send the acknowledgement and reply, and the notification, if any, to one or more of the petitioners rather than to all of them. 1995, c. 43, s. 5.
Duty to monitor	23. (1) The Commissioner shall make any examinations and inquiries that the Commissioner considers necessary in order to monitor
	(a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before the House of Commons under section 24; and
	(b) the replies by Ministers required by subsection 22(3).
Commissioner's report	(2) The Commissioner shall, on behalf of the Auditor General, report annually to the House of Commons concerning anything that the Commissioner considers should be brought to the attention of that House in relation to environmental and other aspects of sustainable development, including
	(a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before that House under section 24;
	(b) the number of petitions recorded as required by subsection 22(1), the subject-matter of the petitions and their status; and
	(c) the exercising of the authority of the Governor in Council under any of subsections 24(3) to (5).
Submission and tabling of report	(3) The report required by subsection (2) shall be submitted to the Speaker of the House of Commons and shall be laid before that House by the Speaker on any of the next fifteen days on which that House is sitting after the Speaker receives it. 1995, c. 43, s. 5.
Strategies to be tabled	24. (1) The appropriate Minister for each category I department shall cause the department to prepare a sustainable development strategy for the department and shall cause the strategy to be laid before the House of Commons
	(a) within two years after this subsection comes into force; or
	(b) in the case of a department that becomes a category I department on a day after this subsection comes into force, before the earlier of the second anniversary of that day and a day fixed by the Governor in Council pursuant to subsection (4).
Updated strategies to be tabled	(2) The appropriate Minister for the category I department shall cause the department's sustainable development strategy to be updated at least every three years and shall cause each updated strategy to be laid before the House of Commons on any of the next fifteen days on which that House is sitting after the strategy is updated.

Governor in Council direction (3) The Governor in Council may, on that recommendation of the appropriate Minister for a department not named in Schedule I to the *Financial Administration Act*, direct that the requirements of subsections (1) and (2) apply in respect of the department.

Date fixed by Governor in Council (4) On the recommendation of the appropriate Minister for a department that becomes a category I department after this subsection comes into force, the Governor in Council may, for the purpose of subsection (1), fix the day before which the sustainable development strategy of the department shall be laid before the House of Commons.

Regulations (5) The Governor in Council may, on the recommendation of the Minister of the Environment, make regulations prescribing the form in which sustainable development strategies are to be prepared and the information required to be contained in them. 1995, c. 43, s. 5.

APPENDIX B

FINANCIAL ADMINISTRATION ACT

R.S., c. F-11

Extracts from Part X

CROWN CORPORATIONS

Financial Management

- | | |
|-------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Books and systems | <p>131. (1) Each parent Crown corporation shall cause</p> <p>(a) books of account and records in relation thereto to be kept, and</p> <p>(b) financial and management control and information systems and management practices to be maintained,</p> <p>in respect of itself and each of its wholly-owned subsidiaries, if any.</p> |
| Idem | <p>(2) The books, records, systems and practices referred to in subsection (1) shall be kept and maintained in such manner as will provide reasonable assurance that</p> <p>(a) the assets of the corporation and each subsidiary are safeguarded and controlled;</p> <p>(b) the transactions of the corporation and each subsidiary are in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and</p> <p>(c) the financial, human and physical resources of the corporation and each subsidiary are managed economically and efficiently and the operations of the corporation and each subsidiary are carried out effectively.</p> |
| Internal audit | <p>(3) Each parent Crown corporation shall cause internal audits to be conducted, in respect of itself and each of its wholly-owned subsidiaries, if any, to assess compliance with subsections (1) and (2), unless the Governor in Council is of the opinion that the benefits to be derived from those audits do not justify their cost.</p> |
| Financial statements | <p>(4) Each parent Crown corporation shall cause financial statements to be prepared annually, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with generally accepted accounting principles as supplemented or augmented by regulations made pursuant to subsection (6) if any.</p> |
| Form of financial statements | <p>(5) The financial statements of a parent Crown corporation and of a wholly-owned subsidiary shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation or subsidiary.</p> |
| Regulations | <p>(6) The Treasury Board may, for the purposes of subsection (4), make regulations respecting financial statements either generally or in respect of any specified parent Crown corporation or any parent Crown corporation of a specified class, but such regulations shall, in</p> |

respect of the preparation of financial statements, only supplement or augment generally accepted accounting principles. 1991, c. 24, s. 41.

Auditor's Reports

Annual auditor's report

132. (1) Each parent Crown corporation shall cause an annual auditor's report to be prepared, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with the regulations, on

(a) the financial statements referred to in section 131 and any revised financial statement referred to in subsection 133(3); and

(b) any quantitative information required to be audited pursuant to subsection (5).

Contents

(2) A report under subsection (1) shall be addressed to the appropriate Minister and shall

(a) include separate statements, whether in the auditor's opinion,

(i) the financial statements are presented fairly in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year,

(ii) the quantitative information is accurate in all material respects and, if applicable, was prepared on a basis consistent with that of the preceding year, and

(iii) the transactions of the corporation and of each subsidiary that have come to his notice in the course of the auditor's examination for the report were in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(b) call attention to any other matter falling within the scope of the auditor's examination for the report that, in his opinion, should be brought to the attention of Parliament.

Regulations

(3) The Treasury Board may make regulations prescribing the form and manner in which the report referred to in subsection (1) is to be prepared.

Separate reports

(4) Notwithstanding any other provision of this Part, the auditor of a parent Crown corporation may prepare separate annual auditor's reports on the statements referred to in paragraph (1)(a) and on the information referred to in paragraph (1)(b) if, in the auditor's opinion, separate reports would be more appropriate.

Audit of quantitative information

(5) The Treasury Board may require that any quantitative information required to be included in a parent Crown corporation's annual report pursuant to subsection 150(3) be audited.

Other reports

(6) The auditor of a parent Crown corporation shall prepare such other reports respecting the corporation or any wholly-owned subsidiary of the corporation as the Governor in Council may require.

Examination

(7) An auditor shall make such examination as he considers necessary to enable him to prepare a report under subsection (1) or (6).

Reliance on internal audit	(8) An auditor shall, to the extent he considers practicable, rely on any internal audit of the corporation being audited that is conducted pursuant to subsection 131(3). 1991, c. 24, s. 42.
Errors and omissions	133. (1) A director or officer of a Crown corporation shall forthwith notify the auditor and the audit committee of the corporation, if any, of any error or omission of which the director or officer becomes aware in a financial statement that the auditor or a former auditor has reported on or in a report prepared by the auditor or a former auditor pursuant to section 132.
Idem	(2) Where an auditor or former auditor of a Crown corporation is notified or becomes aware of any error or omission in a financial statement that the auditor or former auditor has reported on or in a report prepared by the auditor or former auditor pursuant to section 132, he shall forthwith notify each director of the corporation of the error or omission if he is of the opinion that the error or omission is material.
Correction	(3) Where an auditor or former auditor of a Crown corporation notifies the directors of an error or omission in a financial statement or report pursuant to subsection (2), the corporation shall prepare a revised financial statement or the auditor or former auditor shall issue a correction to the report, as the case may be, and a copy thereof shall be given to the appropriate Minister. 1984, c. 31, s. 11.
Auditors	
Appointment of auditor	134. (1) The auditor of a parent Crown corporation shall be appointed annually by the Governor in Council, after the appropriate Minister has consulted the board of directors of the corporation, and may be removed at any time by the Governor in Council, after the appropriate Minister has consulted the board.
Auditor General	(2) On and after January 1, 1989, the Auditor General of Canada shall be appointed by the Governor in Council as the auditor, or a joint auditor, of each parent Crown corporation named in Part I of Schedule III, unless the Auditor General waives the requirement that he be so appointed.
Idem	(3) Subsections (1) and (2) do not apply in respect of any parent Crown corporation the auditor of which is specified by any other Act of Parliament to be the Auditor General of Canada, but the Auditor General is eligible to be appointed the auditor, or a joint auditor, of a parent Crown corporation pursuant to subsection (1) and section 135 does not apply to him.
Exception	(4) Notwithstanding subsection (1), where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the auditor of the subsidiary, and subsections (6) and sections 135 to 137 apply in respect of that auditor as though the references therein to a parent Crown corporation were references to the subsidiary.
Criteria for appointment	(5) The Governor in Council may make regulations prescribing the criteria to be applied in selecting an auditor for appointment pursuant to subsection (1) or (4).
Re-appointment	(6) An auditor of a parent Crown corporation is eligible for re-appointment on the expiration of his appointment.

Continuation in office

(7) Notwithstanding subsection (1), if an auditor of a parent Crown corporation is not appointed to take office on the expiration of the appointment of an incumbent auditor, the incumbent auditor continues in office until his successor is appointed. 1984, c.31, s.11.

Persons not eligible

135. (1) A person is disqualified from being appointed or re-appointed or continuing as an auditor of a parent Crown corporation pursuant to section 134 if that person is not independent of the corporation, any of its affiliates, or the directors or officers of the corporation or any of its affiliates.

Independence

(2) For the purpose of this section,

- (a) independence is a question of fact; and
- (b) a person is deemed not to be independent if that person or any of his business partners
 - (i) is a business partner, director, officer or employee of the parent Crown corporation or any of its affiliates, or a business partner of any director, officer or employee of the corporation or any of its affiliates,
 - (ii) beneficially owns or controls, directly or indirectly through a trustee, legal representative, agent or other intermediary, a material interest in the shares or debt of the parent Crown corporation or any of its affiliates, or
 - (iii) has been a receiver, receiver–manager, liquidator or trustee in bankruptcy of the parent Crown corporation or any of its affiliates within two years of his proposed appointment as auditor of the corporation.

Resignation

(3) An auditor of a parent Crown corporation who becomes disqualified under this section shall resign forthwith after becoming aware of his disqualification. 1984, c.31, s.11.

Qualifications preserved

136. Nothing in sections 134 and 135 shall be construed as empowering the appointment, re–appointment or continuation in office as an auditor of a parent Crown corporation of any person who does not meet any qualifications for such appointment, re–appointment or continuation established by any other Act of Parliament. 1984, c. 31, s. 11.

Resignation

137. A resignation of an auditor of a parent Crown corporation becomes effective at the time the corporation receives a written resignation from the auditor or at the time specified in the resignation, whichever is later. 1984, c. 31, s. 11.

Special Examination

Special examination

138. (1) Each parent Crown corporation shall cause a special examination to be carried out in respect of itself and its wholly–owned subsidiaries, if any, to determine if the systems and practices referred to in paragraph 131(1)(b) were, in the period under examination, maintained in a manner that provided reasonable assurance that they met the requirements of paragraphs 131(2)(a) and (c).

Time for examination

(2) A special examination shall be carried out at least once every five years and at such additional times as the Governor in Council, the appropriate Minister or the board of directors of the corporation to be examined may require.

Plan	(3) Before an examiner commences a special examination, he shall survey the systems and practices of the corporation to be examined and submit a plan for the examination, including a statement of the criteria to be applied in the examination, to the audit committee of the corporation, or if there is no audit committee, to the board of directors of the corporation.
Resolution of disagreements	(4) Any disagreement between the examiner and the audit committee or board of directors of a corporation with respect to a plan referred to in subsection (3) may be resolved <ul style="list-style-type: none"> (a) in the case of a parent Crown corporation, by the appropriate Minister; and (b) in the case of a wholly-owned subsidiary, by the parent Crown corporation that wholly owns the subsidiary.
Reliance on internal audit	(5) An examiner shall, to the extent he considers practicable, rely on any internal audit of the corporation being examined conducted pursuant to subsection 131(3). 1984, c.31, s.11.
Report	139. (1) An examiner shall, on completion of the special examination, submit a report on his findings to the board of directors of the corporation examined.
Contents	<p>(2) The report of an examiner under subsection (1) shall include</p> <ul style="list-style-type: none"> (a) a statement, whether in the examiner's opinion, with respect to the criteria established pursuant to subsection 138(3), there is reasonable assurance that there are no significant deficiencies in the systems and practices examined; and (b) a statement of the extent to which the examiner relied on internal audits. 1984, c.31, s.11.
Special report of appropriate Minister	140. Where the examiner of a parent Crown corporation, or a wholly owned subsidiary of a parent Crown corporation, named in Part I of Schedule III is of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of the appropriate Minister, he shall, after consultation with the board of directors of the corporation, or with the board of the subsidiary and corporation, as the case may be, report that information to the Minister and furnish the board or boards with a copy of the report. 1984, c.31, s.11.
Special report to Parliament	141. Where the examiner of a parent Crown corporation, or a wholly-owned subsidiary of a parent Crown corporation, named in Part I of Schedule III of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the board of directors of the corporation, or with the boards of the subsidiary and corporation, as the case may be, prepare a report thereon for inclusion in the next annual report of the corporation and furnish the board or boards, the appropriate Minister and the Auditor General of Canada with copies of the report. 1984, c.31, s.11.
Examiner	142. (1) Subject to subsections (2) and (3), a special examination referred to in section 138 shall be carried out by the auditor of a parent Crown corporation.
Idem	(2) Where, in the opinion of the Governor in Council, a person other than the auditor of a parent Crown corporation should carry out a special examination, the Governor in Council may, after the appropriate Minister has consulted the board of directors of the corporation, appoint an auditor who is qualified for the purpose to carry out the examination in lieu of the

auditor of the corporation and may, after the appropriate Minister has consulted the board, remove that qualified auditor at any time.

Exception (3) Where a special examination is to be carried out in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the qualified auditor who is to carry out the special examination.

Applicable provisions (4) Subject to subsection (5), sections 135 and 137 apply in respect of an examiner as though the references therein to an auditor were references to an examiner.

Auditor General eligible (5) The Auditor General of Canada is eligible to be appointed an examiner and section 135 does not apply to the Auditor General of Canada in respect of such an appointment. 1984, c. 31, s. 11.

Consultation with Auditor General

Consultation with Auditor General 143. The auditor or examiner of a Crown corporation may at any time consult the Auditor General of Canada on any matter relating to his audit or special examination and shall consult the Auditor General with respect to any matter that, in the opinion of the auditor or examiner, should be brought to the attention of Parliament pursuant to paragraph 132(2)(b) or section 141. 1984, c. 31, s. 11.

Right to Information

Right to Information 144. (1) On the demand of the auditor or examiner of a Crown corporation, the present or former directors, officers, employees or agents of the corporation shall furnish such

(a) information and explanations, and

(b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries

as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the directors, officers, employees or agents are reasonably able to furnish.

Idem (2) On the demand of the auditor or examiner of a Crown corporation, the directors of the corporation shall

(a) obtain from the present or former directors, officers, employees or agents of any subsidiary of the corporation such information and explanations as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the present or former directors, officers, employees or agents are reasonably able to furnish; and

(b) furnish the auditor or examiner with the information and explanations so obtained.

Reliance on reports (3) An auditor or examiner of a Crown corporation may reasonably rely on any report of any other auditor or examiner. 1984, c. 31, s. 11.

Policy

Restriction

145. Nothing in this Part or the regulations shall be construed as authorizing the auditor or examiner of a Crown corporation to express any opinion on the merits of matters of policy, including the merits of

- (a) the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;
 - (b) the objectives of the corporation; and
 - (c) any business or policy decision of the corporation or of the Government of Canada.
- 1984, c. 31, s. 11.

Qualified Privilege

Qualified privilege

146. Any oral or written statement or report made under this Part or the regulations by the auditor or a former auditor, or the examiner or a former examiner, of a parent Crown corporation or a wholly-owned subsidiary has qualified privilege. 1991, c. 24, s. 43.

Costs

Cost of audit and examination

147. (1) The amounts paid to an auditor or examiner of a Crown corporation for preparing any report under section 132, 139, 140 or 141 shall be reported to the President of the Treasury Board.

Idem

(2) Where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred by him in preparing any report under section 132, 139, 140 or 141 shall be disclosed in the next annual report of the Auditor General and be paid out of the moneys appropriated for his office. 1984, c. 31, s. 11.

Audit Committee

Audit committee

148. (1) Each parent Crown corporation that has four or more directors shall establish an audit committee composed of not less than three directors of the corporation, the majority of whom are not officers or employees of the corporation or any of its affiliates.

Idem

(2) In the case of a parent Crown corporation that has less than four directors, the board of directors of the corporation constitutes the audit committee of the corporation and shall perform the duties and functions assigned to an audit committee by any provision of this Part and the provision shall be construed accordingly.

Duties

- (3) The audit committee of a parent Crown corporation shall
 - (a) review, and advise the board of directors with respect to, the financial statements that are to be included in the annual report of the corporation;
 - (b) oversee any internal audit of the corporation that is conducted pursuant to subsection 131(3);

- (c) review, and advise the board of directors with respect to, the annual auditor's report of the corporation referred to in subsection 132(1);
- (d) in the case of a corporation undergoing a special examination, review, and advise the board of directors with respect to, the plan and reports referred to in sections 138 to 141; and
- (e) perform such other functions as are assigned to it by the board of directors or the charter or by-laws of the corporation.

Auditor's or examiner's attendance

(4) The auditor and any examiner of a parent Crown corporation are entitled to receive notice of every meeting of the audit committee and, at the expense of the corporation, to attend and be heard at each meeting; and, if so requested by a member of the audit committee, the auditor or examiner shall attend any or every meeting of the committee held during his term of office.

Calling meeting

(5) The auditor or examiner of a parent Crown corporation or a member of the audit committee may call a meeting of the committee.

Wholly-owned subsidiary

(6) Where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary separately, subsections (1) to (5) apply, with such modifications as the circumstances require, in respect of the subsidiary as though

- (a) the references in subsections (1) to (5) to a parent Crown corporation were references to the subsidiary; and
- (b) the reference in paragraph (3)(a) to the annual report of the corporation were a reference to the annual report of the parent Crown corporation that wholly owns the subsidiary. 1984, c. 31, s. 11.

Reports

Accounts, etc. to Treasury Board or appropriate Minister

149. (1) A parent Crown corporation shall provide the Treasury Board or the appropriate Minister with such accounts, budgets, returns, statements, documents, records, books, reports or other information as the Board or appropriate Minister may require.

Reports on material developments

(2) The chief executive officer of a parent Crown corporation shall, as soon as reasonably practicable, notify the appropriate Minister, the President of the Treasury Board and any director of the corporation not already aware thereof of any financial or other developments that, in the chief executive officer's opinion, are likely to have a material effect on the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives or on the corporation's requirements for funding.

Reports on wholly-owned subsidiaries

(3) Each parent Crown corporation shall forthwith notify the appropriate Minister and the President of the Treasury Board of the name of any corporation that becomes or ceases to be a wholly-owned subsidiary of the corporation. 1984, c. 31, s. 11.

Annual report

150. (1) Each parent Crown corporation shall, as soon as possible, but in any case within three months, after the termination of each financial year submit an annual report on the operations of the corporation in that year concurrently to the appropriate Minister and the President of the Treasury Board, and the appropriate Minister shall cause a copy of the report to be laid before each House of Parliament on any of the first fifteen days on which that House is sitting after he receives it.

Reference to committee	(2) An annual report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to the businesses and activities of the corporation submitting the report.
Form and contents	<p>(3) The annual report of a parent Crown corporation shall include</p> <ul style="list-style-type: none"> (a) the financial statements of the corporation referred to in section 131, (b) the annual auditor's report referred to in subsection 132(1), (c) a statement on the extent to which the corporation has met its objectives for the financial year, (d) such quantitative information respecting the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives as the Treasury Board may require to be included in the annual report, and (e) such other information as is required by this or any other Act of Parliament, or by the appropriate Minister, the President of the Treasury Board or the Minister of Finance, to be included in the annual report,
	and shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation and its wholly-owned subsidiaries, if any.
Idem	(4) In addition to any other requirements under this Act or any other Act of Parliament, the Treasury Board may, by regulation, prescribe the information to be included in annual reports and the form in which such information is to be prepared. 1991, c. 24, s. 49.
Annual consolidated report	151. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause a copy of an annual consolidated report on the businesses and activities of all parent Crown corporations for their financial years ending on or before the previous July 31 to be laid before each House of Parliament.
Reference to committee	(2) An annual consolidated report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to Crown corporations.
Contents	<p>(3) The annual consolidated report referred to in subsection (1) shall include</p> <ul style="list-style-type: none"> (a) a list naming, as of a specified date, all Crown corporations and all corporations of which any shares are held by, on behalf of or in trust for the Crown or any Crown corporation; (b) employment and financial data, including aggregate borrowings of parent Crown corporations; and (c) such other information as the President of the Treasury Board may determine. 1984, c. 31, s. 11.
Annual report	152. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause to be laid before each House of Parliament a copy of a report indicating the

summaries and annual reports that under this Part were to be laid before that House by July 31 in that year, the time at, before or within which they were to be laid and the time they were laid before that House.

Attest

(2) The accuracy of the information contained in the report referred to in subsection (1) shall be attested by the Auditor General of Canada in the Auditor General's report to the House of Commons. 1991, c. 24, s. 44.

APPENDIX C

REPORTS TO THE HOUSE

Thursday, 27 November 1997

The Standing Committee on Public Accounts has the honour to present its FIRST REPORT

In accordance with Standing Order 108(3)(e), the Committee considered Reports of the Committee presented to the House during the last few months of the Thirty-fifth Parliament and the Committee agreed to request that the Government provide to the Committee comprehensive responses, in accordance with the provisions of Standing Order 109, to the following Reports of the Committee:

- the Fourth Report (*Revenue Canada - Combatting Income Tax Avoidance*), presented on February 10, 1997;
- the Fifth Report (*Service Quality*) presented on April 7, 1997;
- the Sixth Report (*Canada Infrastructure Works Program - Lessons Learned*) presented on April 14, 1997;
- the Seventh Report (*Materiel Management in the Federal Government*) presented on April 15, 1997; and
- the Ninth Report (*Human Resources Development Canada - Canada Pension Plan: Disability*) presented on April 23, 1997.

A copy of the relevant Minutes of Proceedings (*Meeting No. 10*) and a copy of the above-mentioned Reports are tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Thursday, 27 November 1997

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

SECOND REPORT

The Standing Committee on Public Accounts has considered Chapter 12 of the April and October 1997 Report of the Auditor General of Canada (Information Technology: Preparedness for Year 2000) and the Committee has agreed to the following report:

Introduction

As the year 2000 approaches, governments, the private sector, and individuals are faced with potential computer and information systems malfunctions that may have serious consequences. These malfunctions will result if systems are either not replaced or repaired before 2000. Solving the problem, which is a global one, will be labour- and time-intensive, and the estimated costs are enormous. The potential costs of failing to take timely, effective action may be even higher. This issue is commonly referred to as the Year 2000 challenge.

In his October 1997 Report, the Auditor General of Canada informed Parliament that the rate of progress achieved by the federal government in preparing its systems for 2000 has generally been slow. He cited a government estimate that the repair and replacement process will cost \$1 billion and indicated that unless urgent and aggressive action is taken, government systems will not be converted in time. The consequences, he warned, could be severe.

Based on the information contained in the Auditor General's Report, the size of estimated cost of solving the problem, and the urgent action required to avoid costly systems failures, the Committee assigned priority to investigating this issue. Accordingly, the Committee met with the Auditor General of Canada, Mr. Denis Desautels, and Mr. René Guindon (Visiting Assistant Deputy Minister, Year 2000 Project Office) and Mr. Paul Rummell (Chief Information Officer) of the Treasury Board Secretariat on 28 October 1997.

Observations and Recommendations

During its meeting with witnesses, the Committee learned that although progress had been made since the audit was completed in March 1997, the overall prognosis is still not good. In his opening statement to the Committee, the Auditor General summarized his conclusion on completion of his audit: "the rate of progress has generally been slow and ... the residual risks for systems errors and failure ... remain high." Despite work by the Treasury Board Secretariat, and departments and agencies, the Auditor General told the Committee that he remained

Concerned that continuous delivery of major government programs and essential services into the 21st century remains at risk. The potential consequences for the government could be manifested as health and safety concerns, financial implications, disruption to essential services for the public or legal ramifications.

Under questioning from the Committee, Mr. Desautels asserted that the assessment made by his Office in April 1997 continues to be "largely representative of the challenges ahead," and that "at this point remain very large, very serious."

For their part, the witnesses from Treasury Board Secretariat pointed out that progress had been made since the audit's completion. Although they carefully avoided giving any guarantees that all systems would be repaired or replaced by 1 January 2000, they expressed confidence that the government could meet the Year 2000 challenge. They readily acknowledged the size of this challenge and that much still remains to be done.

The Committee recognizes the progress that has been made and wishes to acknowledge the work done by departments and the Treasury Board Secretariat. Nevertheless, the Committee is concerned that despite efforts to date, government systems — particularly in key areas — may not be fully replaced or repaired in time. This concern is heightened by the Auditor General's observation, in his report, that in the past, "only 16% of [the federal government's information] systems were delivered on time and within budget."

The concerns of the Committee fall under six categories: accurate costing and the availability of resources to address the issue; contingency plans; service to the public; integrity of data banks; accountability and the role of Treasury Board Secretariat; and, information for Parliament. Accordingly, the Committee makes the following observations and recommendations.

Estimated Costs and the Availability of Resources

In his Report, the Auditor General indicated that according to its own estimate, the cost to the federal government of meeting this challenge could be approximately \$1 billion. Treasury Board Secretariat witnesses confirmed this estimate, which they asserted, is still accurate, more than five months after it was first made. They acknowledged, however, that costing in many departments is still incomplete. According to the Auditor General, the \$1 billion figure

Is a global estimate arrived at by making some rough calculations ... it's not a department by department estimate of where they are at and how much each [department] is going to need to carry this out,...

As Mr. Desautels stated (with the agreement of TBS witnesses) the estimate — although the best one available — is a "soft" one. It is thus clear to the Committee that, at this stage, no one has a definitive estimate of the total costs involved in solving the Year 2000 challenge.

Treasury Board officials did not know how much of this estimated total had been spent to date. In further testimony, they indicated that departmental spending on the problem came mostly out of existing budgets. Treasury Board Secretariat, they added, is now in the process of determining whether or not costs in addition to existing budgets will be involved.

In his report, the Auditor General indicates that Treasury Board Secretariat plans called for updates of departmental progress in September 1997 and January 1998. Yet when pressed for details on progress to date, Secretariat witnesses repeatedly told the Committee that they would not have answers until December 1997. Nevertheless, they told the Committee on several occasions that much progress had been made since the Auditor General had completed his audit.

Perhaps the lack of solid information also prevented Secretariat witnesses from being more precise about staffing plans. According to their testimony, there are approximately 8,000 government employees who now work in the information technology area. Government has announced plans to hire an additional 2000 and to increase levels of pay. When asked, however, whether those now working in this area would be taken away from current assignments in order to solve the problem, the witnesses did not comment.

The absence of a more accurate estimate on total costs combined with uncertainty over the allocation of human resources poses two problems: whether sufficient resources will be devoted to correct the problem; and, if not, whether technology installation and upgrade projects now underway will have to be cancelled or postponed. As

witnesses pointed out, costs are now being covered out of existing budgets. This sets up a tension between the need to solve the Year 2000 problem and the need to complete other technology installation and upgrade projects.

The Committee fully expects that a firmer estimate, based on a department by department analysis, will help clarify some of these issues. In the meantime, it recommends:

That the government, as it responds to the year 2000 challenge, identify critical technology installation and upgrade projects now under development and take steps to ensure that these projects are maintained.

The Committee is anxious that the Chief Information Officer Branch within Treasury Board Secretariat and its Year 2000 Project Office has the necessary assistance. As the Auditor General stated, the CIO's office "will need a lot of support" in order to meet this enormous challenge successfully. The Committee is concerned with achieving solutions and therefore recommends:

That Treasury Board and Treasury Board Secretariat give the Chief Information Officer Branch the full support and assistance necessary to resolve the Year 2000 challenge successfully.

As 2000 draws closer, competition for the services of individuals with the skills needed to fix the problem will intensify. The Committee heard evidence that competition for skilled individuals is already occurring. The Committee is aware that the CIO Branch has developed an action plan for managing human resources in the information technology community that addresses Year 2000 issues. There is a need, however, for a contingency plan in case this action plan is insufficient. The Committee therefore recommends:

That Treasury Board Secretariat recognize the growing competition for the services of individuals with the skills needed to resolve the Year 2000 challenge and draw up an internal contingency staffing plan.

Another area of concern involves the need for contingency plans. In his report, the Auditor General advised Parliament that at the time of his audit "none of the nine [audited] departments ...[had] started preparing substantive contingency plans for their systems." (12.83) He also reported that only three of 50 departments and agencies that responded to a survey replied that they had developed contingency plans; none of them supplied a copy.

In answer to questions put to them, Secretariat witnesses told the Committee that the development of contingency plans "is not priority one." Instead, the focus is on fixing the problem. In his Report, however, the Auditor General advises that many departments and agencies will be unable to test their systems that have been repaired or replaced before 01 January 2000. To the Committee, this means that these systems will be exposed to the risk of failure while they are operational. This in turn means that alternative methods of supporting the delivery of essential programs should be available in case they are needed.

The Committee believes all departments that deliver critical programs that are exposed to risk must have contingency plans in place in case the support technologies for them fail. The Committee therefore strongly recommends:

That Treasury Board Secretariat ensure that all departments and agencies that deliver programs that are exposed to risk and that directly affect the health, security, and economic well-being of Canadians, have contingency plans proportional to the level of risks involved in place to sustain those programs in the event of systems failure on 1 January 2000.

The Committee is also concerned that in the effort to identify priorities and develop contingencies, a focus on the delivery of service to citizens will not receive sufficient attention. When asked about this issue, the Chief Information Officer of Treasury Board Secretariat told the Committee:

I cannot [un]equivocally say that customer service, meeting the needs of the individual Canadian citizen, the businesses, the small businesses, the large businesses of Canada, is the central focus of our mission..

The Committee believes that this factor needs to be given greater prominence in the Year 2000 project, and therefore recommends:

That the Chief Information Officer Branch and the Year 2000 Project Office attach a priority to quality of service delivery to citizens and that it communicate this priority to all government departments and agencies.

Accountability and the Role of Treasury Board Secretariat

Accountability is an issue that is of greatest importance to this Committee. In terms of taking effective action and achieving satisfactory results, there is great merit in having one department, and one individual within that department capable of taking the lead responsibility for solving problems. Knowing who holds the responsibility means knowing who is in a position to make decisions and to act on them. It means knowing who is in charge.

When the Committee asked questions in this area, it was told that departments are responsible for ensuring that their systems are adequately prepared for 2000. Treasury Board Secretariat, for its part, is responsible for providing guidance and leadership on this challenge throughout government, particularly in the search for solutions to common problems.

Under normal circumstances, this may be an appropriate division of responsibility. In this instance, however, in the opinion of the Committee, more assertive action by Treasury Board Secretariat will be necessary. In his Report, the Auditor General calls on the Secretariat to attach priority to identifying and monitoring the government's most critical systems. He also calls for strategic intervention in the event that repair efforts in critical areas are falling behind. This will require the Secretariat to go beyond its usual role as a leader and facilitator and intervene strategically where necessary.

In light of these considerations, and in light of the urgency attached to the Year 2000 challenge, the Committee therefore recommends:

That Treasury Board Secretariat assume full responsibility and authority for resolving the Year 2000 problem and ensure that the lines of its authority in this regard are clearly understood by all departments and agencies.

It is also important that one person within the Secretariat assume the responsibility for meeting this challenge. Yet there was some ambiguity in the testimony given by Secretariat officials. In the written version of his opening statement, Mr. René Guindon, the Visiting Assistant Deputy Minister, Treasury Board Secretariat Year 2000 Project Office, indicated that he has the "responsibility for the Year 2000 issue within CIO Branch of Treasury Board Secretariat." During testimony, however, Mr. Paul Rummell, the Chief Information Officer, told the Committee that he carries "the primary sponsorship for this project." To clear up any confusion, the Committee recommends:

That Treasury Board Secretariat clearly identifies whom, within the Secretariat, holds the principal responsibility for the Year 2000 project, as quickly as possible.

In his Report, the Auditor General asserts that Parliament should be kept informed of the Year 2000 challenge and the government's progress in preparing for it. The Committee agrees with this assertion. As the central agency that monitors departmental progress in countering the Year 2000 challenge, the Treasury Board Secretariat is best positioned to provide Parliament with this information. The Committee notes that Secretariat officials responded positively to its requests for more detailed information and wishes to encourage the Secretariat to act expeditiously on its intentions. The Committee therefore recommends:

That Treasury Board Secretariat submit its work plan for government-wide Year 2000 initiatives to the Public Accounts Committee no later than January 31, 1998; and

That Treasury Board Secretariat submit a report to the Public Accounts Committee on the progress that has been achieved across all government departments and agencies by January 31 1998, and at six-month intervals thereafter, up to and including January 31, 2001.

The Committee is anxious that the reports tabled by Treasury Board Secretariat on preparedness for the Year 2000 contain information that is timely and relevant. To that end the Committee recommends:

That progress reports on Year 2000 preparedness include the following information:

- **Progress in each phase of the conversion project (inventory, assessment and planning; conversion; and testing and implementation), including timelines and deadlines, for each department and agency;**
- **An evaluation of the repaired and replaced systems that have been tested and the results;**
- **Mission-critical systems, an impact analysis showing the risk associated with each of them, and an indication of which of these systems have contingency plans in place; and**
- **A continuing evaluation of the costs, broken down by department and agency, of fixing the problem, an aggregate of these costs, and a statement of the method by which they were calculated.**

The Committee is aware that in some instances it may be more appropriate to replace a system rather than upgrade it. Upgrading a system that will have to be replaced in the near future would represent an unwarranted expenditure of scarce resources. Accordingly, the Committee recommends:

That Treasury Board Secretariat, in co-operation with various affected departments, conduct a full and detailed assessment of existing systems with the view of replacing outdated technology where appropriate instead of upgrading it to the year 2000.

The Committee is also deeply aware that departments and agencies will face increasing difficulties in obtaining the software and hardware needed to address the Year 2000 challenge. Accordingly, they will have to assess their needs and, where appropriate, make the necessary purchases as quickly as possible. Treasury Board Secretariat has a role to play in making the departments and agencies aware of this necessity. In light of these considerations, the Committee also recommends:

That Treasury Board Secretariat include, in its progress reports on the response to the Year 2000 challenge, status reports on efforts to obtain the hardware and software from vendors that is needed to solve the problem.

Under normal circumstances, the Office of the Auditor General would conduct a follow up audit two years after the completion of an initial audit. In these circumstances, however, this subsequent action would occur far too late to have any positive influence over the outcome. Constructive participation in the exercise will therefore have to occur much sooner. All of the status reports on the Year 2000 challenge prepared by the Treasury Board Secretariat will be forwarded to the Office of the Auditor General. Consequently, the Committee recommends:

That the Auditor General conduct a thorough review of the reports tabled by the Treasury Board Secretariat on the Year 2000 challenge, and report his conclusions to Parliament.

In closing, the Committee believes that the way in which individual departments and agencies are dealing with this challenge ought to be reported to the Standing Committees of the House of Commons that oversee them. In its Performance Report for the period ending 31 March 1997, Treasury Board Secretariat does provide information on its efforts to resolve the Year 2000 problem. Others should follow this example. Accordingly, the Committee recommends:

That Part III of the Estimates (Reports on Plans and Priorities) for 1998–99, and subsequent fiscal years, and Performance Reports beginning in autumn 1998, for all departments and agencies, contain specific reference to efforts (planned and actual) and expenditures (planned and actual) devoted to meeting the Year 2000 challenge.

Conclusion

Based on the testimony of its witnesses, the Committee believes that progress is being made in the effort to ensure that the major systems of government will continue to function on 1 January 2000. Confirmation of this progress, however, and an indication of its actual extent, will have to await Treasury Board Secretariat's report.

In the meantime, it is important not to be complacent. Indeed, witnesses were unanimous in the view that the challenge is a serious one and will require constant effort.

From the Committee's perspective, the response to the Year 2000 challenge illustrates several of the Committee's principal interests. They are accountability, the need for timely, reliable, and comprehensive solutions to problems, and the assurance that Canadians will be well served by their government.

The Committee is convinced that a satisfactory response to its concerns and recommendations with respect to the Year 2000 challenge will contribute significantly to its solution.

Pursuant to Standing Order 109, the Committee requests the Government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (*Meetings Nos. 5 and 10*) are tabled.

Respectfully submitted,

John Willams

Chair

REPORTS TO THE HOUSE

Thursday, 11 December 1997

Human Resources Development Canada — A Critical Transition Toward Results-based Management

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

THIRD REPORT

The Standing Committee on Public Accounts has considered Chapter 17 of the April and October 1997 Report of the Auditor General of Canada (*Human Resources Development Canada — A Critical Transition Toward Results-Based Management*) and the Committee has agreed to report the following:

Introduction

Since the 1960s, advocates of public service reform have proposed the adoption of results-based management. This form of administration places an emphasis on results and outcomes, instead of process, an approach that narrowly defines success in terms of the ability to do things ‘by the book.’ Supporters of results-based management have argued that by adopting this approach, accountability for achieving policy goals would be strengthened, and programs better designed and implemented.

Until recently, the federal public service has been slow to implement a results-based approach to management. As a consequence of diminished resources and fiscal pressures, however, the government has recently begun the transition toward managing for results. This transition has received the support of the Auditor General and, in past parliaments, the House of Commons Standing Committee on Public Accounts.

In his April and October 1997 Report, the Auditor General included a chapter describing the transition toward results-based management in a major department, Human Resource Development Canada, whose activities affect the lives of millions of Canadians. This department is responsible for delivering some of the most important services of the federal government, in areas such as employment insurance, income security, and student loans. The Department’s expenditures in these areas are considerable. In 1996–97, for example, it made disbursements totalling \$56 billion, including payments from the Employment Insurance (EI) Account and the Canada Pension Plan (CPP).

Because the Committee assigns a great deal of importance to efforts to achieve results-based management in the federal public service, the magnitude of expenditures involved, and the Canadians affected by the Department’s actions, the Committee decided to examine the report on its move toward results-based management. Accordingly, the Committee held a hearing with the Auditor General of Canada, and with Mr. Ian Green, Associate Deputy Minister, and Mr. Marcel Nouvet, Assistant Deputy Minister of Finance and Administration, both of Human Resources Development Canada, on 4 November 1997.

Observations and Recommendations

From its study of the Auditor General’s Report, and from its meeting with witnesses, the Committee is generally satisfied that HRDC is making progress in implementing results-based management. At the end of the meeting, Mr. David Rattray, Assistant Auditor General, told the Committee that HRDC “is in fact one of the

departments that is making a fairly substantial effort at moving towards results-based management.” He added that the Office of the Auditor General has “an overall fairly positive score card on HRDC” in this regard. The Committee takes a similar view.

Despite the Department’s accomplishments, however, the Committee believes that progress is uneven in a number of vital respects. In the interests of encouraging the Department to make further progress, the Committee offers the following observations and recommendations.

Performance Indicators

The Department has identified the indicators that it will use to measure its performance in delivering services. These indicators are divided into primary and secondary indicators and differ in terms of their availability to Parliament in departmental performance reports. The results of measures taken under primary indicators are reported to Parliament; those taken under secondary indicators are not. As secondary indicators, cost and efficiency are not part of the information on program performance that is presented to Parliament.

The Committee believes that the absence of this information weakens Parliament’s ability to assess how well programs are being delivered. The Committee notes that the Department is already gathering data with respect to cost and efficiency; reporting this data to Parliament should not impose significant cost or extra effort for HRDC. The Committee therefore recommends:

That Human Resources Development Canada should designate cost and measures of efficiency as primary performance indicators and report this information to Parliament in Part III of its Estimates and in its Performance Reports.

Now that the Department has selected its performance indicators, it needs to use them consistently in order to allow performance to be compared from year to year and to establish trend lines. According to the Auditor General’s Report, the Department is currently revisiting its key indicators for 1998–99. Mr. Ian Green, Associate Deputy Minister of Human Resources Development, told the Committee that he is aware of the need to sustain present indicators in order for them to be measurable and effective. The Committee welcomes the Department’s commitment to its present set of indicators and wishes to see this commitment maintained. It accordingly recommends:

That Human Resources Development Canada should retain its current set of primary and secondary performance indicators for as much time is needed to identify trends and to allow both Parliament and the Department to determine whether performance is improving or deteriorating.

Information for Parliament

A key advantage of results-based management is its ability to generate relevant information for Parliament. This facilitates the Department’s accountability to Canadians and to Parliament for the management of its resources and for the results it has produced.

From the Auditor General’s Report and testimony given by witnesses, the Committee learned that much—but not all—of the relevant information regarding the Employment Insurance Account is presented to Parliament. However, this information is not available in any single document. This makes it difficult to assess the results achieved in the operation of the Account, which is wholly funded by employers and employees.

The Committee notes that the Department already produces a single annual report on the Canada Pension Plan that is tabled in Parliament. In his audit, the Auditor General comments positively on this report. The Committee also notes that most of the information regarding the EI Account is already publicly available; placing

this information in one document should not impose a burden on the Department. Therefore, the Committee recommends:

That, beginning in fiscal year 1998–99, Human Resources Development Canada prepare an annual report on the Employment Insurance Account for tabling in Parliament. This report should compare results against stated objectives and include audited financial statements, a summary of the services provided, the clientele served, and the benefits paid.

Several important pieces of information regarding the Account are currently not available to Parliament. The actuarial analyses used to set the premium rates for the Account are not made public. This is in contrast to the CPP where such analyses are released annually. Also unavailable is a determination of a reasonable reserve for the Account and the time required to accumulate it. The Committee believes that such information is necessary to strengthen transparency surrounding the setting of premium rates. It therefore recommends:

That the Chief Actuarial Officer of the Office of the Superintendent of Financial Institutions prepare, on an annual basis, an actuarial analysis for the Minister of Finance to be used in recommending the setting of premium rates for the Employment Insurance Account, and that the Minister of Finance table this report in the House of Commons; and

That Human Resources Development Canada includes, in an annual report on the Employment Insurance Account, the actuarial analyses used to set premium rates for the Account and the level of a reasonable reserve for the Account along with the time needed to build it.

As the Auditor General points out in his Report, there is a special importance attached to the Employment Insurance Account. In light of the Account's importance, the Committee believes that the obligation to issue an annual report ought to be a formal one with a legislative basis, as is the case with regard to the Canada Pension Plan. The Committee therefore recommends:

That the *Employment Insurance Act* be amended to require Human Resources Development Canada to prepare an annual report on the Employment Insurance Account for presentation to the House of Commons.

Conclusion

Human Resources Development Canada has made significant strides toward the implementation of results-based management. This achievement is particularly commendable in light of the challenges involved in bringing about cultural change in large organizations. Success in this department, one of the largest and most important in government, should serve as an example to other departments and agencies.

The Committee wishes to encourage the Department to make further progress, an effort that the Committee believes will be assisted through adoption of its recommendations.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings* (*Meetings Nos. 6, 12 and 13*) are tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Thursday, 11 December 1997

Transport Canada: The Commercialization of the Air Navigation System

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

FOURTH REPORT

The Standing Committee on Public Accounts has considered Chapter 19 of the April and October 1997 Report of the Auditor General of Canada (Transport Canada – The Commercialization of the Air Navigation System) and the Committee has agreed to report the following:

Introduction

On 31 October 1996, Canada's civil air navigation system was transferred from Crown ownership to a private not-for-profit corporation, NAV CANADA. NAV CANADA was given a legislated monopoly in perpetuity to operate the system. In return, the Crown received a payment of \$1.5 billion.

This transfer was significant in terms of the nature of the assets and amounts of money involved; this was one of the federal government's largest divestitures. The use of a private contract as a vehicle for the transfer, the creation of a not-for-profit corporation to purchase and operate the system, and the relatively short time in which the transfer was completed, also made this commercialization unusual.

As a consequence of the nature of this transaction, and because future divestitures are likely, the Committee met with the Auditor General of Canada, Mr. L. Denis Desautels, Ms. Margaret Bloodworth, Deputy Minister, Transport Canada (the Department) and Mr. Colin Potts, Deputy Comptroller General, Treasury Board Secretariat, on 18 November 1997, to discuss this issue.

Observations and Recommendations

In his Report and in his opening statement to the Committee, the Auditor General concentrated on the actions taken by the Department in commercializing the air navigation system. According to his assessment, the Department had not conducted a thorough valuation of the system. Furthermore, he argued that when the Department recommended acceptance of a purchase price, it reconciled that price against an adjusted net book valuation. The Auditor General deemed this inappropriate. These observations call into question the Department's achievement of one of two financial objectives that government set for the divestiture — obtaining fair market value for the air navigation system.

The Department did not dispute the core arguments advanced by the Auditor General. Ms. Bloodworth, the Deputy Minister, told the Committee that "*the appropriate way to value [the air navigation system] was a going concern and not net book value.*" She added that "*in general, in principle we do agree [with the Auditor General] on that issue.*" She also agreed that the documentation used to support both the net and going concern valuations of the system was incomplete. This, she explained, "*was the reason why the Department did not ask its financial advisors to provide a formal valuation opinion.*" Later on she stated that "*in the end fair market value is what a buyer is prepared to pay.*"

However, in her testimony, the Deputy Minister explained that the price obtained for the system was reasonable and a good deal for the government and taxpayers. She stated that the policy objectives established by the government for the commercialization had been attained and expressed general satisfaction with the way in which the transfer had been accomplished.

The Committee acknowledges that even with some slippage the Department fundamentally succeeded in respecting the timeframes for the transfer. It also observes that — in the absence of evidence to the contrary — most of the basic goals set for the divestiture appear to have been met to some degree. The Committee also wishes to affirm that on the basis of the evidence it reviewed, it is satisfied that those involved in the transfer acted with integrity. As the Auditor General stated at the end of the meeting,

“we believe that people probably acted in good faith and we have no reason to think otherwise.”

Nevertheless, the Committee believes that there are several important lessons that can be learned from this divestiture. These lessons need to be applied to future exercises of this sort.

The Department has conducted a study to identify lessons learned from the commercialization and to identify key strategic issues for future divestitures. It has produced an interim report based on this study. In its Performance Report for the period ending 31 March 1996, Transport Canada also indicated that following the transfer, the Department would “develop a framework to determine whether the objectives of the transfer have been achieved.” The Auditor General noted that the Department had yet to make a comprehensive report to Parliament on the results of the divestiture.

In the Committee’s view, a comprehensive report is required so that the Department can provide Parliament with a thorough assessment of the results of the divestiture. Accordingly, the Committee recommends that:

The Department prepare a comprehensive report on the commercialization of the air navigation system for tabling in the House of Commons by 1 April 1998. This report should include a final report on the lessons learned from the transfer, the results of the Department’s evaluation exercise, and a full accounting of the costs involved in the transfer.

In his testimony and in his Report, the Auditor General asserted that the Department did not show due regard to economy in conducting the commercialization. He emphasized that

Due regard to economy does not mean that the purchase price must equal the valuation; rather, it means that the value must be known and any difference should be explained. (19.26)

The Department agreed that a going concern valuation was most appropriate in terms of determining a purchase price for the system. Its own financial advisors provided a going concern valuation of \$2.4 billion. The Department obtained a purchase price for the system of \$1.5 billion. The Department reconciled this price through reference to an adjusted net book value for the system of \$1.9 billion.

In order to demonstrate that it exercised due regard to economy in obtaining the purchase price that it did, the Department should be able to reconcile the price against what it agrees is an appropriate valuation. The Committee therefore recommends that:

Transport Canada reconcile the purchase price for the air navigation system by reference to the going concern value provided by its financial advisors and that it include this reconciliation in its report to the House of Commons.

From evidence produced in the Auditor General’s Report and during the meeting, the Committee discovered that documentation used in the valuation process was incomplete. It also learned that the Department’s

financial advisors were not required to provide a formal valuation opinion. Although these factors resulted from conditions surrounding the transfer, the Committee believes that they must be avoided in future divestitures. The Committee therefore recommends that:

The government clearly establish that formal valuations from financial advisors and full financial documentation are absolute requirements that must be satisfied for all divestitures.

Committee also learned that Transport Canada entered into negotiations to transfer the system before it had developed a complete understanding of the assets to be divested. This produced a situation in which a determination of certain key elements of the system occurred during the negotiation phase. It also resulted in valuations that changed during the negotiation process and makes it difficult to determine whether the purchase price of \$1.5 billion is appropriate. The Committee believes that assets to be divested should be clearly defined before negotiation begins. It therefore recommends that:

In all divestitures, the government clearly define and document the nature and value of the assets in question prior to negotiating their transfer.

The Auditor General also raised a number of concerns regarding the manner in which the Department contracted for financial advice used in conjunction with the commercialization. In the Department's view, the contracts were handled in a reasonable manner, given the circumstances. Mr. Colin Potts, Deputy Comptroller General, supported the Department's overall handling of the transfer.

The Committee is concerned, however, that while the Department may not have violated any procedures set forth for contracting, certain of its actions could and should be improved. In order to ensure that, in future, all contracts are issued in a fair and appropriate manner, the Committee recommends that:

Treasury Board Secretariat conduct a thorough review of the government's contracting regulations, with specific reference to the concerns raised in the Auditor General's Report, and that it report its conclusions to this Committee no later than 31 May 1998.

The Committee notes that in handling this divestiture, Transport Canada was engaging in an activity outside its normal sphere of operations. Such divestitures are complex and require a set of specific skills not traditionally found in most government departments. As a consequence, the Committee believes that there would be an advantage in having a third party assume responsibility for overseeing future divestitures. Therefore, the Committee recommends that:

When government is contemplating a divestiture, it form a special privatization committee with the specific mandate and skills to supervise the divestiture.

In his Report and testimony to the Committee, the Auditor General observed that Transport Canada had yet to provide Parliament with a comprehensive report on the results of the divestiture. The Committee believes that the results of all divestitures, particularly when they involve major assets and operations of government, should routinely be reported to Parliament. Therefore, the Committee recommends that:

The government, upon completion of any divestiture, table a comprehensive report on the results in the House of Commons. Such reports should include a statement of the objectives set for the divestiture, the full costs of the exercise, and the results.

In closing, the Committee notes that the government decided to transfer the air navigation system to a not-for-profit organization that it created for this purpose. This organization — NAV CANADA — was given a legislated monopoly in perpetuity with the legal right to recover all of its costs and accumulate reserves. The Auditor

General indicated in his testimony that the legislation enables NAV CANADA “*to charge users for the service’s availability rather than its use.*” The Committee observes that while NAV CANADA is made up of partners and is responsible for providing a service that is safe, it has no shareholders to whom it must answer. In light of these general observations, the Committee recommends that:

In conducting future divestitures, the Government devote careful thought to the nature of the entity that will assume the assets and operations, and the context within which it will operate.

As the structures of government undergo change, it is likely that divestitures will continue. It is vital that the lessons learned from previous divestitures be learned and applied. It is also important that these exercises be transparent and conducted with due regard to economy.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A dissenting opinion from the Bloc Québécois is appended to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 8 and 14)* are tabled.

Respectfully submitted,

JOHN WILLAMS

Chair

Bloc Québécois Dissenting Opinion

Fourth Report of the Standing Committee on Public Accounts

Commercialization of the Air Navigation System:

Liberal Bad Management in All Its Glory

The Liberals have thrown away almost one billion dollars of public money by selling off cheap a monopoly in perpetuity on the air navigation system. Once again they have failed to display either strict standards or professionalism, as the Auditor General pointed out in his report of October 1997.

In addition to having literally wasted \$900 million, no one in the government is willing to take responsibility for the mess, or for the decisions the new agency may make in the future. By making NAV Canada independent of the government, no member of the government — and most definitely not the Minister of Transport — seems willing to answer for the loss of the \$900 million, and still less for NAV Canada's decision to let 1,100 of its employees go.

The Bloc Québécois accuses the Liberals of having cheated the taxpayers of Quebec and Canada out of this \$900 million, and the Minister of Transport of having washed his hands of the 1,100 employees who are losing their jobs. We hope that the government will implement the recommendations in the report of the Committee.

REPORTS TO THE HOUSE

Thursday, 12 February 1998

Health Canada — First Nations Health

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

FIFTH REPORT

The Standing Committee on Public Accounts has considered Chapter 13 of the April and October 1997 Report of the Auditor General of Canada (*Health Canada — First Nations Health*) and the Committee has agreed to report the following:

Introduction

As a matter of policy, the federal government provides health services to Canada's approximately 640,000 status Indians and Inuit (First Nations). Health Canada is responsible for this service through its Health Services Branch. The goal set by the Department is to "assist" First Nations to "attain a level of health comparable for that of other Canadians living in similar locations." In fiscal year 1995–96, expenditures in this area totalled approximately \$1 billion.

In accordance with overall government priorities, Health Canada is moving away from direct delivery of health services to First Nations. Instead, status Indians and Inuit will increasingly manage and control their own health services at the community level.

Due to the large numbers of Canadians directly affected, the costs involved, and the crucial transition to community control that is currently taking place, the Committee decided to examine Health Canada's management of this service. To this end, the Committee met with Mr. Denis Desautels, the Auditor General of Canada, and Mrs. Maria Barrados, the Assistant Auditor General, on 26 November 1997. Mr. Paul Cochrane, Assistant Deputy Minister, Medical Services Branch, Dr. Jay Wortman, Director General of Non-Insured Health Benefits, and Ms. Myra Conway, Director of Programs and Operations Coordination, appeared on behalf of Health Canada.

Observations and Recommendations

Health Canada's Health Services Branch oversees the provision of health services to First Nations under two basic programs. The first, Community Health Programs, is made up of programs and activities related to public health and health education, and strategies to deal with specific problems such as drug and alcohol abuse. Non-Insured Health Benefits (NIHB), the second program, provides prescription and over-the-counter drugs, dental services, and transportation for medically required services. In fiscal year 1995–96, expenditures on these two programs amounted to approximately \$450 and \$516 million respectively.

In his Report of October 1997, the Auditor General was critical of the Department's management of these programs. He indicated that the Department was not paying sufficient attention to the delivery of Community Health Programs nor to the results achieved in terms of improved health. With respect to the Non-Insured Health Benefits, he found that the Department's lack of rigorous management and control may have contributed to poor community health rather than its improvement. He also argued that in the absence of stringent audits, money was being spent in ways contrary to the program's intent. The Auditor General reiterated these observations in his statements to the Committee.

The Department did not disagree with the Auditor General's observations. Instead, departmental witnesses emphasized that Health Canada was already aware of many of the problems brought to light by the audit, and is now taking steps to correct them. The witnesses indicated that cost management measures are having positive results — a factor noted by the audit. They also argued that delivery of health services to First Nations faces numerous challenges and that problems associated with the programs were not dissimilar to those found in other health service regimes.

The Department has agreed to virtually all of the audit's recommendations and has pledged to implement each one of them. Some efforts are already underway to implement changes while others are being planned. The Committee welcomes Health Canada's commitment to resolve the problems identified by the audit. While in some cases, the Department has been aware of these difficulties for almost ten years, the availability of new technologies and methodologies should result in a speedier response.

The Committee is anxious that the Department fulfil its commitments and that the changes will result in better management of health services and improved health for First Nations communities. Accordingly, the Committee makes the following recommendations.

Community Health Programs

Community Health Programs are delivered by First Nations' communities under a variety of arrangements with the Department. These arrangements differ in terms of the degree of control exercised by the communities concerned. According to departmental data, as of 31 March 1997, 60 percent of First Nations' communities were delivering programs under separate contribution agreements. In theory, this kind of arrangement gives communities the least amount of control and requires the greatest departmental involvement.

The Department's goal is to encourage communities to exercise greater control offered under arrangements known as "transfer agreements." According to the Auditor General, the Department has estimated that by 1999–2000 approximately 60 percent of First Nations will be delivering their health services under this type of arrangement. (13.24) The Auditor General approves of the accountability framework, developed by the Department, that will govern the transfer process.

The Committee supports the goal of greater community control. Nevertheless, the audit's findings give reason for concern that the transfer process may not be adequately managed. The Department was not carefully monitoring separate contribution agreements to ensure that program conditions were being met. The accountability framework for the transfer process— although good in itself — was not being applied with sufficient rigour.

The Department must ensure that the transfer process functions smoothly, that First Nations develop the capacity to control their health services, that the health of communities and individuals is enhanced, and that the Minister of Health's accountability for the expenditure of public funds and health outcomes is properly supported. To do so, the Department must apply the transfer framework as intended. The Committee therefore recommends:

That Health Canada monitor the transfer of the delivery of Community Health Programs to First Nations communities and work with the communities to ensure that the conditions set forth in the accountability framework are met. In particular, the Department must ensure that the audit (both financial and comprehensive) and evaluation requirements of all transfer agreements are satisfied.

The director of the Medical Services Branch, Mr. Paul Cochrane, told the Committee that it is the policy of the Department that First Nations take control of the health programs "at a pace and at a time of their own choosing." As a consequence, some communities may decide not to enter into transfer agreements. In these instances, Health Canada must improve its monitoring, in accordance with its own policies, to ensure that it can fulfil its obligations. The Committee therefore recommends:

That Health Canada monitor those aspects of the Community Health Program that are not affected by transfer agreements. This monitoring function must be done in accordance with departmental policies, be supported by thorough evaluation of risk, and targeted accordingly.

The Committee believes that it is essential that Parliament be kept informed of the progress of the transfer process and the results it produces. Parliament must also receive assurance from the Department that all Community Health Programs are being adequately monitored and that all reports and audits are completed and submitted as required. Accordingly, the Committee recommends

That Health Canada provide information on the status of Community Health Programs in its annual Performance Reports. Information on the status of the transfer process, the Department's monitoring activities, audits and reports completed, and health outcomes achieved under the programs should be included.

Non-Insured Health Benefits

The audit's most serious findings involve the Department's delivery of the Non-Insured Health Benefits program. According to the Auditor General, poor management and control have contributed to the inappropriate use of benefits supplied under the program.

The Department has acknowledged that problems exist and has taken steps to resolve them. Most importantly, it has implemented a point-of-sale system designed to identify cases of possible prescription drug abuse. This system was intended to be fully operational by the end of 1997; the Committee asks that the Government confirm the same in its comprehensive response to this Report.

These measures have the potential to reduce many of the problems associated with provision of prescription drugs under NIHB. There are, however, areas in which the point-of-sale system should be improved. As a result of legislation in various jurisdictions, information is restricted to the last three prescriptions. Pharmacists can override warning messages sent by the system. As yet, there is no compensation scheme in place that will give pharmacists an incentive to decline prescriptions on the basis of these warnings.

The Committee notes that in British Columbia, privacy legislation has been amended in order to allow pharmacists to see a fourteen-month prior history of prescriptions. The Committee therefore recommends:

That Health Canada explore the possibility, with various jurisdictions, of having access to information and privacy legislation amended in order to allow its point-of-sale system to provide more information on recent prescriptions.

The Committee also recommends:

That Health Canada monitor the use of overrides by pharmacists and step up its efforts to devise an incentive scheme for those pharmacists who do not fill prescriptions when warning messages are issued.

The Department has indicated that the Non-Insured Health Benefits program will become available for transfer to First Nations communities as of 1 April 1998. Greater community control over this program offers the potential for better delivery. The Committee is concerned, however, that First Nations communities not inherit systemic problems associated with the program. The Committee therefore recommends:

That Health Canada fix systemic problems with the NIHB program before the program becomes available for transfer to First Nations communities.

The Committee is also concerned that when the transfer of the NIHB program begins, it be conducted in a way that will build capacity in the First Nations communities and support accountability relationships. The Committee notes the Auditor General's endorsement of the framework being used to govern the transfer of the Community Health Program. It therefore recommends:

That Health Canada adopt and apply the framework for transferring Community Health Programs when it conducts the transfer of the Non-Insured Health Benefits program to the First Nations.

Claims Processing for Pharmacy and Dental Providers

The audit revealed problems in the processing of claims submitted by pharmacy and dental providers under the NIHB program. These problems were largely the result of an inadequate audit regime.

In October 1997, the Department announced that a new five-year contract for claims processing had been awarded. This contract will take effect as of 1 July 1998.

Dr. Jay Wortman told the Committee that the Department is aware that the language in the existing contract "was weak in the area of audit," and that it was planning to have stronger language incorporated into the new contract. The Committee welcomes this determination on the part of the Department and recommends:

That Health Canada submit a copy of the new contract for processing pharmacy and dental claims under the NIHB program to the Committee by 1 June 1998.

Optimal Therapy

It is the Committee's view that Health Canada should establish optimal therapy as a central goal of the NIHB program. This would mean ensuring that those covered by the program get the appropriate drugs they need to improve their health status or particular condition. If this were the program's goal, the Committee is convinced that there would be greater opportunities for savings because clients, physicians and pharmacists would be better informed and better care provided. While the Department does include aspects of an optimal therapy approach to some elements of the program, it should apply it to the program as a whole. The Committee therefore recommends:

That Health Canada work with First Nations Communities to establish optimal therapy as the central goal of the NIHB program and include references to this effort in its annual Performance Reports.

Conclusion

As noted, the Department has made a commitment to implement the entire list of the Auditor General's recommendations. Mr. Cochrane told the Committee that "each one of these recommendations ... will be followed up with a detailed action plan." He indicated his willingness to provide the Committee with a copy of this plan. Ms. Myra Conway told the Committee that a draft of the plan would be completed by the end of November 1997. The Committee recommends:

That Health Canada provide the Committee with a copy of its action plan for carrying out the recommendations made by the Auditor General by 30 April 1998. This plan should include target implementation dates, and a discussion of how the Department proposes to monitor and report the changes and the results that are achieved.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 11 and 16)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Thursday, 26 March 1998

Fisheries and Oceans Canada — Pacific Salmon: Sustainability of the Resource Base

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

SIXTH REPORT

The Standing Committee on Public Accounts has considered Chapter 28 of the December 1997 Report of the Auditor General of Canada (*Fisheries and Oceans Canada Pacific Salmon: Sustainability of the Resource Base*) and the Committee has agreed to report the following:

Introduction

The pacific salmon is a valuable resource for the citizens and communities of British Columbia as well as for Canada as a whole. The commercial salmon fishery was worth \$265 million annually during 1986 - 1995. A recent survey indicated that the recreational fishery generated more than \$228 million in direct expenditures by anglers in 1990 alone. Many Canadians, especially the citizens and communities in British Columbia, have expressed a strong interest in, and commitment to, preserving this important resource for the use and enjoyment of generations to come.

In light of the value of this resource and its importance to the people of British Columbia and Canada, the Committee decided to study Chapter 28 of the Auditor General's December 1997 Report. The audit in this chapter focused on the sustainability of the salmon resource base, with an emphasis on the conservation and protection of salmon habitat. A second phase of the audit will look at salmon fisheries management including fishing plans and the allocation of resources to major users. The Auditor General intends to report the results of this second phase in 1999.

To understand the challenges involved in the conservation and preservation of pacific salmon habitat, the Committee met on 12 February 1998 with Mr. Denis Desautels, the Auditor General of Canada, and Mr. John McCullough, Principal of Audit Operations, and Mr. Geoffrey Robins, Director of Audit Operations, from the Office of the Auditor General of Canada. Mr. Wayne Wouters, Deputy Minister, Ms. Cheryl Fraser, Assistant Deputy Minister - Policy, Mr. Scott Parson, Assistant Deputy Minister — Science, and Ms. Donna Petrachenko, Regional Director, Pacific Region, represented the Department of Fisheries and Oceans.

The Committee learned that although pacific salmon are doing well at the aggregate level, individual species such as the chinook and coho may be declining and that many small stocks are under stress or are threatened.

There are several causes for stress on the salmon resource, including changes in the ocean and climate. However, evidence shows that the alteration of salmon habitat leading to its loss is a significant factor in placing stress on the resource.

Since jurisdiction over the fisheries in Canada is divided between the federal and provincial governments, the Department must work with the Province of British Columbia in order to deliver its habitat program. It must also work closely with communities, aboriginal groups, interested groups and individuals, and other stakeholders.

The Department of Fisheries and Oceans is mandated, under the *Fisheries Act*, to protect fish habitat from disruptive and destructive activities. The Department is guided by its Policy for the Management of Fish Habitat (1986) (the Habitat Policy) and the Habitat Conservation and Protection Guidelines (1994). The Policy's objective is "net gain" which is met through concentration on three goals: conservation, restoration, and development of fish habitat. In 1996–97, the Department's Pacific Region spent \$10.3 million, or 11.6 percent of its total fisheries management budget, on habitat management activities.

The Department must work in a challenging and complex environment to deliver its habitat program. Recent agreements between the governments of Canada and British Columbia promise better co-ordination and delivery of efforts to conserve salmon habitat. Apart from these agreements, however, the Committee believes that there are several areas in which the Department must improve its performance if it is to achieve the objective of "net gain" established by its Habitat Policy.

Observations and Recommendations

In his Report and his testimony, the Auditor General indicated the importance of smaller salmon stocks of all species in protecting genetic diversity and ensuring the sustainability of the resource as a whole. Yet the Department has tended to concentrate its efforts on the major stocks with the result that it lacks assessment data on many of the smaller stocks. The Committee is concerned that this focus neglects the importance of smaller stocks. It notes that Deputy Minister Wouters agreed that there is a need to provide greater emphasis on the whole area of minor stocks and recommends:

That the Department of Fisheries and Oceans adopt a balanced approach to the protection of, and production from, all salmon stocks and that it allocate its resources accordingly. This approach must be clearly reflected in the Department's policies, accountability documents and other publications.

Furthermore, the Committee recommends:

That the Department of Fisheries and Oceans establish a strategy to collect and assess the data necessary to monitor and report on the status of smaller stocks, and that it establish and make public a deadline for doing so.

Apart from the limited data and assessment with regard to small stocks as alluded to in paragraph 9 the audit found that information on salmon stocks is not well co-ordinated and is not always available easily. The Department will need this information if it is to concentrate its efforts and resources where they will be most effective. The Department's partners in habitat protection will also need this information for their own planning purposes. The Committee therefore recommends:

That the Department of Fisheries and Oceans develop and implement a strategy, in co-operation with the Province of British Columbia and other partners in habitat management, to collect and manage information on Pacific salmon stocks. This strategy must include clear goals, definitions of responsibility, and target implementation dates.

The Committee is of the view that groups and individuals interested in contributing to habitat preservation represent an invaluable resource for the Department. This is particularly so given the limited resources available. These groups and individuals not only help preserve habitat, they are also a source of information on the status of salmon stocks. Their contribution must be encouraged and the Department is making efforts in this respect. The Committee wishes to see these efforts continue and therefore strongly recommends:

That the Department of Fisheries and Oceans develop and implement a plan whose specific purpose is to engage and encourage the assistance of groups and individuals interested in preserving salmon

stocks and habitat. This plan — including target implementation dates — must be developed in close consultation with the groups and individuals themselves.

The Committee notes that the Department delivers some aspects of its Habitat Policy through arrangements with its partners such as the Government of British Columbia and First Nations. The Committee is concerned, however, by a general absence of accountability frameworks in many of these agreements. The audit finding that these arrangements are not subject to monitoring and audit by the Department is also of concern. The Committee believes that this issue should be resolved when future arrangements are set in place. It therefore recommends:

That as it negotiates agreements with its partners in habitat management, the Department of Fisheries and Oceans negotiate the inclusion of accountability frameworks to ensure that the requirements of the *Fisheries Act* are met. These frameworks must include clear statements of expectations, responsibilities, and provisions for monitoring, auditing, and the reporting of outcomes.

Furthermore, the Committee recommends:

That the Department of Fisheries and Oceans monitor and audit the arrangements under which it delegates habitat management responsibilities.

The audit found that the Department relies heavily on reactive measures to protect salmon habitat. These measures are focused on the review of proposed development projects with a potential impact on salmon habitat. The Department can recommend changes to projects to offset damage to habitat. This, however, necessitates monitoring to ensure compliance and the assessment of the impact of proposed changes on habitat. The audit found that the Department did not place sufficient emphasis on these latter measures, particularly with regard to smaller projects. The Committee believes the Department must place more emphasis on monitoring and follow up and therefore recommends:

That the Department of Fisheries and Oceans establish the level of monitoring and follow-up of habitat projects that is necessary to ensure compliance and assess the impact on 'no net loss.' The need to monitor small projects must be factored into this consideration.

To protect habitat, the Department should also adopt a more proactive approach by becoming involved in the planning stages of projects at the community level. This provides an opportunity to ensure that projects will either avoid harming habitat or that mitigating or compensatory aspects can be built into them. The Committee learned however, that the Department has encouraged rather than instructed its staff to become involved in planning initiatives. The Committee believes that such involvement will solve problems before they develop. It also takes note of Ms. Petrachenko's testimony that "if our [the Department's] proactive work on the planning front doesn't work, we end up having to use enforcement...." Involvement at the planning stages might therefore reduce the necessity for after-the-fact monitoring and enforcement. Accordingly, the Committee recommends:

That the Department of Fisheries and Oceans revise its Habitat and Conservation Guidelines of 1994 in order to instruct its staff to become involved in major integrated resource and land use planning initiatives.

The Auditor General reports that the Department has not prepared an overview report on the status of fish habitat conservation in Canada since the introduction of the Habitat Policy in 1986. Mr. Wouters told the Committee that the Department is currently undertaking a strategic review of its habitat management program in British Columbia. He also made a commitment to appear before the Committee once the review is completed to summarize the results and discuss how the Department will proceed. He anticipated that the review will be completed in October 1998. The Committee also notes the Department of Fisheries and Oceans' positive general response to the recommendations made by the Auditor General. The Department indicated that it has acted on some

recommendations and is planning to address others. The Committee welcomes Mr. Wouters' and the Department's commitments and recommends:

That the Department of Fisheries and Oceans conduct a full strategic review of its Habitat Policy to determine its performance in achieving the Policy's goals and overall objective of 'net gain', and that it report the results by December 1998. This report must also contain the Department's agreed upon responses to the concerns and recommendations of the Auditor General as expressed in Chapter 28 of his December 1997 Report.

The Committee believes that such evaluations must be conducted at regular intervals and the results provided to Parliament. It therefore recommends:

That the Department of Fisheries and Oceans establish a timetable for the regular review and evaluation of its habitat management policies and practices; and

That the Department of Fisheries and Oceans report the results of habitat management and policy reviews to Parliament in its annual Performance Reports.

Furthermore, because the Committee believes that habitat management is a vital component of the Department's mandate, it recommends:

That the Department of Fisheries and Oceans include, in updates of its sustainable development strategy, references to its habitat management policies and practices.

Finally, because the Committee believes that information on the status of Pacific salmon resource is of vital importance, it recommends:

That the Department of Fisheries and Oceans include information on the status of the Pacific salmon resource at both the species and stock levels in its Annual Report to Parliament.

In closing, the Committee is aware that the protection of habitat is one component of the effort to ensure the sustainability of the Pacific salmon. It notes that the Auditor General will conduct a second phase of his audit of the pacific salmon fishery that will focus on other aspects of sustainability. The Committee considers it important to view sustainability in its entirety and may revisit the results of the first phase in conjunction with any review of the second.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 17 and 23)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Thursday, 2 April 1998

Public Accounts of Canada 1996–97

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

SEVENTH REPORT

The Standing Committee on Public Accounts has considered the *Public Accounts of Canada 1996–97* and the Committee has agreed to report the following:

Introduction

The *Public Accounts of Canada* summarise the financial transactions made by the Government of Canada during a given fiscal year, ending on 31 March. Included in the Public Accounts are statements of the Government's assets and liabilities, revenues and expenditures, the accumulated deficit, changes in financial position, and a statement of transactions. The latter reveals the extent to which cash going out from the government exceeded cash coming in, with the resulting net borrowing.

These financial statements are presented to the Auditor General of Canada who audits them and provides an independent opinion to the House of Commons. The statements along with the Auditor General's opinion are tabled in the House of Commons in the form of the *Public Accounts of Canada* and are referred to the Standing Committee on Public Accounts for examination.

On 28 October 1997, the *Public Accounts of Canada 1996–97* were tabled in the House of Commons and referred to the Committee. On 9 December 1997, the Committee met to examine the *Public Accounts of Canada*. Mr. Raymond Dubois, Deputy Auditor General, Mr. Ron Thompson, Assistant Auditor General, and Mr. John Hodgins, Principal of Audit Operations, appeared as witnesses from the Office of the Auditor General of Canada. Mr. J. Colin Potts, Deputy Comptroller General, and Mr. Rick Neville, Assistant Secretary and Assistant Comptroller General, appeared as witnesses on behalf of Treasury Board Secretariat.

This report presents the Committee's observations and recommendations arising from that meeting.

Observations and Recommendations

According to section 6 of the *Auditor General Act*, the Auditor General shall examine the financial statements as required by the *Financial Administration Act* and contained in the *Public Accounts* and

shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have. (1976–77, c. 34, s. 6; 1980–81–82–83, c. 170, s. 25.)

Although the Auditor General indicated that in his opinion, the financial statements for 1996–97 "present fairly, in all material respects, the financial position of the Government of Canada as of March 31 1997," he added that:

The 1996–97 deficit is overstated by \$800 million, and both accounts payable and accrued liabilities as well as the accumulated deficit are overstated by the same amount. This results from the recording of a transaction related to the Canada Foundation for Innovation as if it were a liability, which is contrary to the stated accounting policies of the Government of Canada as set out in note 1 to the financial statements. The \$800 million has been recorded as owing to an organization that was not in existence at March 31, 1997 (the Foundation was not legally created until April 1997). Further, the funding agreement between the Government and the Foundation was not signed until the July 1997.

During the meeting, witnesses from the Auditor General's Office confirmed that a qualified opinion had been issued for the public accounts for fiscal year 1996–97. Mr. Raymond Dubois, Deputy Auditor General, informed the Committee that the qualified opinion is

... a very serious matter. What this type of opinion says is that members of this Committee and other users of the financial statements should be aware that they contain a material or significant misstatement.

In his testimony, Mr. Ron Thompson reiterated that in the view of the Office of the Auditor General the \$800 million transaction was recorded before the Canada Foundation for Innovation (the Foundation) was established and the transfer actually made. He argued that recording the transaction in this manner contravened the government's own accounting rules and the accounting and reporting practice recommended by the Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants. Instead, the transaction should have been recorded in the 1997–98 fiscal year, the period during which the Foundation was created and the actual payment made.

Mr. Potts acknowledged that the Auditor General and the government could not reach agreement on the accounting treatment for the transfer of \$800 million to the Foundation. In contrast to the Auditor General's view, the government believes that the costs should be charged in 1996–97, the fiscal year in which the Cabinet's decision to establish the Foundation and transfer the funds was taken and made public. According to Mr. Potts, the government considered that this decision constituted "an irrevocable commitment," and that recording the decision in the 1996–97 fiscal year "reflected the economic reality of financial decision-making" at the time. He indicated furthermore that the government's commitment was confirmed by Parliament through the passage of legislation before the 1996–97 books of government were closed. With regard to the transfer of funds, Mr. Potts also pointed out that payment — although it took place in July 1997 — occurred before the accounts for the year were closed off. He concluded that in its accounting treatment of this transaction, the government had adopted a conservative approach.

In response to questions from the Committee and in subsequent testimony, the witnesses firmly maintained their positions on this matter.

The Committee was divided on the issue of whether or not the accounting treatment of this transaction was appropriate. Some members shared the view of the Office of the Auditor General; others believed that the government's explanations were satisfactory and reasonable.

We note the points raised by the Auditor General and understand fully the rationale and basis for his concerns. However, the Committee is of the view that a broader range of factors must be taken into account for a changing economy and a changing financial position in Canada.

For example, these include such items as conservatism, consistency, comparability, and clarity of the statements to the reader.

We also note the remarks of Mr. Ron Thompson, Assistant Auditor General, that the government "has made considerable progress in recent years in making its annual financial statements more understandable and more

useful." He added that Canada "remains at the forefront internationally for this crucial form of accountability reporting...this is something that we should all take great pride in."

We especially note the clear and well-developed opinion of the Finance Department in conjunction with the Comptroller General's office with regard to the accounting practices employed in these financial statements (A copy of the relevant documentation is attached to this report. *See Appendix "A"*).

The Committee believes that transparency and accountability to Parliament and Canadians are best served by recording non-recurring liabilities in the year in which they are incurred, provided the enabling legislation or authorization for payments receives parliamentary approval before the financial statements for that year are closed.

Therefore, the Committee accepts and applauds the Government for its actions of making its financial statements more transparent and understandable by Canadians.

A second important issue raised by the Auditor General involves the manner in which the government records and reports the estimated liabilities of its employees' pensions. The Auditor General observes that there is a \$20 billion gap between the liability shown for these pensions (\$114 billion) and the liability estimated by the government's actuaries (\$94 billion). He is sufficiently concerned that if adjustments are not made in 1998 to bring accounting into line with PSAAB guidelines, he will seriously consider qualifying his audit Opinion for that year.

Mr. Potts told the Committee that the government is seriously considering the Auditor General's recommendation and hopes to have the issue resolved by 31 March 1998. In the meantime, the government is adhering to a legislative requirement that obliges it to calculate interest on a balance in a superannuation account. This results in a higher amount.

The Committee believes that the government should act expeditiously to address the Auditor General's concerns and therefore recommends:

That the government take all necessary measures — including legislative amendment and adjustment of its stated accounting policies — needed to record and report liabilities for the pensions of its employees in accordance with PSAAB guidelines. Such measures should be completed and in place for the 1998–99 fiscal year.

The Auditor General also listed accounting for environmental liabilities and contingencies, capital assets, tax revenue, and the Debt Servicing and Reduction Account as matters of continuing concern. In his testimony, Mr. Potts indicated the government's intention to address each of these concerns in a timely manner. The Committee trusts that the government will act quickly and in consultation with the Auditor General to resolve these issues.

Conclusion

The Committee takes its responsibility for reviewing the Public Accounts very seriously. As Mr. Neville indicated in his opening statement:

The main purpose of this financial reporting [contained in the Public Accounts of Canada] is to provide information to Parliament, and thus to the public, to allow an understanding of the financial affairs of the government and of the resources with which it has been entrusted.

The Committee also firmly agrees with Mr. Raymond Dubois, who stated in his opening remarks that the government's financial statements "are an important accountability document." Thus the Committee considers that its review of these statements is a central element in holding government to account on behalf of citizens and taxpayers. It is because this document and its review by a committee of Parliament is so vital that this Committee

believes so strongly in the necessity for clear accounting rules and rigorous, consistent adherence to them. There must be no room for confusion regarding the manner in which the use of public funds is reported.

In his opening remarks, Mr. Thompson stated that the government “has made considerable progress in recent years in making its annual financial statements more understandable and more useful.” He added that Canada “remains at the forefront internationally for this crucial form of accountability reporting. ... this is something that we should all take great pride in.” The Committee agrees and believes that its recommendations and continuing efforts by the government and the Office of the Auditor General will further enhance the credibility and utility of the government’s financial statements.

The Committee also notes that at the international level there is considerable variance in the way that governments record and report their financial statements. This often makes international comparison difficult. The Committee recommends:

That the Government of Canada seek opportunities to establish international accounting standards for governments.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A dissenting opinion from the members of the opposition parties is appended to this Report.

A copy of the relevant *Minutes of Proceedings* (*Meetings Nos. 13, 16 and 23*) is tabled.

Respectfully submitted,

John Williams

Chair

Dissenting Opinion to the Seventh Report of the Standing Committee on Public Accounts

Respectfully submitted by:

Odina Desrochers, M.P.
Jason Kenney, M.P.
Philip Mayfield, M.P.
Elsie Wayne, M.P.

Gurmant Grewal, M.P.
René Laurin, M.P.
Lorne Nystrom, M.P.
John Williams, M.P.

In lieu of paragraphs 3–7 on page 4 and paragraph 1 on page 5, all the parties in Opposition agree and submit the following:

Despite this lack of a common perspective, the Committee is in agreement that the rules governing the calculation of the government's financial statements must be clear and appropriate. They must also be adhered to without deviation; practice and policy must be in alignment. The Committee takes note of Mr. Neville's statement that the government "for the most part" follows accounting policies recommended for governments by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. (15.40). Thus, while the federal government alone determines its accounting policies, it does so within the framework of guidelines established by the PSAAB, an independent third party. The Committee also notes that this is the second consecutive occasion on which the Auditor General has issued a qualified opinion as a result of a similar accounting practice by government. If the government and the Auditor General cannot resolve this matter, there is a possibility that the Auditor General might issue a reservation on the next set of government financial statements. The Committee believes that every effort must be made to avoid this possibility. Accordingly, the Committee recommends:

That the Government of Canada and the Auditor General review and attempt to reconcile their differences of interpretation with regard to government accounting policies with careful reference to the accounting and financial reporting recommendations of the Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants.

Furthermore, the Committee recommends:

That, if the Government and the Auditor General are unable to resolve this problem, the matter be submitted to the Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants for further clarification.

In addition, in lieu of paragraph 3 on page 6, all the parties in Opposition agree to the following:

The parties in Opposition laud the efforts of the Government to ensure that its financial statements are transparent, understandable and more useful. However, due to the concerns that the Auditor General has raised regarding the Government's accounting practices, it is clear that these goals are not being met.

The parties in Opposition believe that the Government must focus their efforts to ensure that these goals are met in accordance with the expectations stated by the Auditor General of Canada.

REPORTS TO THE HOUSE

Tuesday, 28 April 1998

The Standing Committee on Public Accounts has the honour to present its
EIGHTH REPORT

In accordance with its Order of Reference of Thursday, February 26, 1998, your Committee has considered Vote 30 under FINANCE of the Main Estimates for the fiscal year ending March 31, 1999 and reports the same.

A copy of the relevant *Minutes of Proceedings* (*Meeting No. 27*) is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Tuesday, 12 May 1998

The Processing of Refugee Claims

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

NINTH REPORT

The Standing Committee on Public Accounts has considered Chapter 25 of the December 1997 Report of the Auditor General of Canada (*Citizenship and Immigration Canada and Immigration and Refugee Board — The Processing of Refugee Claims*) and the Committee has agreed to report the following:

Introduction

The process of determining refugee status is difficult and takes place within the context of complex laws and regulations. A balance must be achieved between compassion for refugee claimants and the fundamental needs of Canadian society; a society committed to providing safe haven for genuine refugees.

The costs associated with the refugee claims processing system are considerable. Fragmentary data indicate that the administrative costs to the federal government of processing claims amounts to approximately \$100 million each year. The provinces are responsible for providing a variety of social services to support claimants. In Quebec and Ontario, a partial estimate puts these costs at about \$100 million each on an annual basis. Due to changing arrangements, particularly in Ontario, many of the costs related to the support of claimants are borne by municipalities. In summary, the costs are such that widespread benefits could be achieved through greater efficiencies in the processing of claims.

Because determination of refugee status is important and because the associated costs are substantial, the Committee decided to examine Chapter 25 of the Auditor General's December 1997 Report. Accordingly, on 5 February 1998 the Committee met with Mr. Denis Desautels (Auditor General of Canada), Mr. Richard Flageole (Assistant Auditor General) and Mr. Serge Gaudet (Principal, Audit Operations) from the Office of the Auditor General. Ms. Janice Cochrane (Deputy Minister) and Mr. Marc Lafrenière (Associate Deputy Minister) represented the Department of Citizenship and Immigration. Ms. Nurjehan Mawani (Chairperson), Mr. Paul Thibault (Executive Director) and Mr. John Frecker (Deputy Chairperson, Convention Refugee Determination Division) represented the Immigration and Refugee Board.

Owing to the complexity and importance of this issue, a second meeting was held on 17 February 1998. Mr. Denis Desautels, Mr. Richard Flageole, and Mr. Serge Gaudet appeared as witnesses from the Office of the Auditor General. Mr. Greg Fyffe (Assistant Deputy Minister, Policy and Program Development), Mr. Georges Tsai (Assistant Deputy Minister, Corporate Services), and Mr. Brian Grant (Acting Director General, Enforcement Branch) appeared on behalf of the Department of Citizenship and Immigration. Mr. Paul Thibault and Mr. John Frecker represented the Immigration and Refugee Board.

Background

The responsibility for processing refugee claims is divided between the Department of Citizenship and Immigration (the Department) and the Immigration and Refugee Board (the Board).

The Department and the Board are independent from one another. The Department decides whether claimants are eligible for access to the refugee determination system. The Convention Refugee Determination Division within the Board is then responsible for determining if the claimant really is a refugee under the terms of the *United Nations Convention Relating to the Status of Refugees*. If the claim is rejected, then the Department is responsible for removing the claimant from Canada. The Department is also responsible for handling other avenues of appeal open to rejected claimants who still wish to remain in Canada.

This structure and its practices were implemented in 1989 in response to a backlog of some 85,000 unprocessed claims. The new arrangements were expected to produce quick, equitable and efficient resolution of claims and the removal of failed claimants.

Observations and Recommendations

The Committee learned that the current structure and practices are not meeting their objectives. The backlog of unprocessed claims is high (close to 37,500 awaiting a decision by the Department or the Board as of 31 March 1997) and processing is lengthy. In 1996–97, it took an average of 13 months to process a claim. Removals of rejected claimants were also problematic: of the approximately 31,200 claimants denied refugee status between 1993–1997, or were not otherwise accepted in Canada, only 22 percent had confirmed their departure. The Auditor General estimates that a claimant can expect to stay in Canada for more than two and a half years. He also estimates that those who have been ordered removed but have not left on average have been in Canada for two and a half years.

The causes of these problems are not confined to any specific area of the claims processing system; they are found at every stage of the process. The Auditor General reports that he found “problems of efficiency and operational effectiveness and a lack of rigour at various stages,” and observed “weaknesses that pervade the entire process — a lack of co-ordination, integration, strategic direction, and overall follow-up.” (25.35) As he points out, piecemeal change will not solve the problems uncovered by the audit.

Witnesses from the Department and the Board were quick to acknowledge the audit findings and agreed to implement all of the Auditor General’s recommendations. The Committee was informed that several initiatives are now under way and that more are to come. The Committee is also aware that the Legislative Review Advisory Group (the Advisory Group) tasked by the Minister of Citizenship and Immigration to advise her on the best future direction for Canadian immigration laws has reported its findings. Many of the Advisory Group’s recommendation deal directly with issues raised in the audit and are now the subject of extensive consultations.

The Auditor General acknowledged the Advisory Group’s contribution. In addition he suggested that there might be other ways to address the concerns he has raised. The Committee agrees, and presents the following recommendations in the hope that they will contribute to the review and rebuilding effort and that they will lead immediately to efficiencies in the process.

The Department is responsible for determining eligibility for access to the system. The audit reveals several problems at this stage. Rulings are often made in the absence of relevant information. Although genuine refugees often have good cause to be without sufficient documentation, close to 60 percent of claimants lack such documentation. Yet since 1993, over 99 percent of the claims have been judged eligible. If more diligence were exercised at an early stage, strain on the process might be reduced. The Committee therefore recommends:

That the Department of Citizenship and Immigration develop a strategy to make the initial examination of claims more rigorous to ensure that eligibility criteria are met. This strategy must include targets and implementation deadlines.

Of those claiming refugee status in Canada, the majority arrives from a country other than the one in which they claim that they were subject to persecution. In 1989, Parliament gave the Department the authority to deny

access to the refugee claims process by claimants arriving from countries known to respect human rights. The audit revealed, however, that this authority has never been used. Ms. Cochrane told the Committee that the government prefers to negotiate responsibility-sharing agreements on a bilateral basis with countries considered to be safe third countries. She indicated that this was a political, rather than an administrative decision. The Committee believes that application of this authority would help relieve pressure on the claims processing system. It therefore recommends:

That the Government of Canada assign priority to negotiation of responsibility sharing agreements with countries considered to be safe third countries.

The results of the audit show clearly that the timely collection and sharing of relevant data presents a challenge to both the Department and the Board. For example, the Auditor General commented that the Department's information systems "could not compile the information needed to account for the resources used in processing refugee claims." (25.38) Information gathered when claims are initially examined could be more complete and relevant, and could be better shared between the Department and the Board. (25.48 - 25.50) The Department has insufficient information to oversee the granting of permanent residence on humanitarian and compassionate grounds. (25.129) It also lacks the information it needs to manage removals effectively. (25.138) The Department, according to the Auditor General, "does not know how many persons are ready for removal." (25.138).

During testimony, departmental officials indicated that the Department has a plan in place to deal with the situation. A new case management system is expected to be in place during the first part of 1999. This system is intended to address the shortcomings identified by the audit. Apart from this, Ms. Cochrane acknowledged that the Department's systems "are old and they don't allow us [the Department] to capture the kind of information that we need."

If the Department and the Board are to manage the claims process efficiently, they need access to data that is timely and complete. This information is also needed to support the accountability of the Department and the Board for their activities related to refugee claims processing. The Committee therefore recommends:

That the Department of Citizenship and Immigration and the Immigration and Refugee Board develop a strategy to put in place the information systems needed to address gaps identified by the Auditor General. This strategy must include an evaluation of costs and expected benefits as well as targets and implementation deadlines.

The Committee also notes that the Department and the Board are now making a greater effort to share the information that they have gathered and to co-ordinate their efforts in general. These are steps in the right direction and the Committee encourages the Department and the Board to pursue them with renewed vigour.

As indicated, information on the activities of the Department and the Board is needed to support accountability. Yet the Auditor General observed that neither the Department nor the Board have provided complete and relevant information on the processing of refugee status claims in their Estimates documents (*Performance Reports, Reports on Plans and Priorities*). The Committee believes that the quality of this information must be improved and notes that the Department and the Board have agreed to do so. Accordingly, the Committee recommends:

That the Department of Citizenship and Immigration and the Immigration and Refugee Review Board provide information on their activities related to refugee status determination in their annual *Performance Reports*. This information must be based on a set of clearly articulated performance measurements and emphasize results rather than process.

The Committee shares the concerns of the Auditor General with regard to the appointment of members to the Board. In order to make decisions that are both fair and timely, Board members must have sufficient experience

with the system. The audit shows that in the recent past, terms of appointment have been relatively short and that there has been a high turnover among members. This results in low productivity and helps add to the backlog of unprocessed claims. Additional costs are also incurred as the result of the need to train new members. Ms. Mawani indicated that longer terms are helpful to the Board. The Committee notes that recently, the terms of appointment have been longer and turnover has been reduced. Because it is important to maintain a workable level of expertise on the Board, the Committee recommends:

That the government increase the length of appointment when it renews the terms of members of the Immigration and Refugee Review Board. In particular, the government should take past performance into consideration when it re-appoints members for longer terms.

Under existing legislation, hearings at the Board can take place with only one member present provided the claimant has consented. According to the Board's *Performance Report* for the period ending 31 March 1997, single-member hearings, with consent of the claimant, grew from 9 percent of all hearings in 1995–96 to 21 percent in 1996–97. Elsewhere in the *Report*, the Board indicates that the increased use of single-member panels contributed to the Board's productivity gains during 1996–97. The Committee believes that pending any possible legislative change, this avenue offers the potential for added efficiencies and therefore recommends:

That the Board actively explore ways in which to increase the number of hearings that are held with one member present.

The Committee is also concerned that the Board may not have sufficient resources to carry out its mandate. Ms. Mawani testified that with a steady complement of members (currently 169) and a yearly intake of 25,000 claimants, the Board expects that its processing times will be eight months by fiscal year 2000 - 2001. She projected that the pending caseload would be 19,000.

Mr. Thibault indicated that with additional personnel, processing delays would be reduced. In his Report, the Auditor General indicated that the United States and the Netherlands have substantially increased staff in order to reduce backlogs and abuses of the system. (25.14) The Committee believes there is merit in studying the staffing levels for the Board and recommends:

That the Immigration and Refugee Review Board review its staffing requirements in order to determine the increased efficiencies that would be produced through the appointment of additional members beyond its current complement.

The audit's finding that the Department has difficulty in carrying out removals is troubling. In his Report, the Auditor General indicated that of the approximately 31,200 claimants ordered removed between 1993 and 1997, only 22 percent confirmed that they had left the country. Furthermore, during testimony he told the Committee that at the end of his audit, the Department was able to confirm the departure of only 4,300 of the 19,900 persons who were to have left Canada.

While improvements in the collection and management of data referred to earlier should assist the removal effort, more needs to be done. Ms. Cochrane told the Committee that the Department has developed a comprehensive removal strategy. However, this strategy is only effective to the extent that it is implemented and decisions within its framework taken promptly. The Committee therefore recommends:

That the Department of Citizenship and Immigration make specific reference to actions taken and the results obtained under its comprehensive removal strategy in its *Performance Report* for the period ending 31 March 1998, and annually thereafter.

As noted, proposals to reform Canada's immigration policies, including the processing of refugee claims, are now under close scrutiny. Fundamental change to the way in which claims are processed is likely. Given the

complexity of the issue and the challenges facing the Department and the Board, it is vital that the transition between the current system and a new one be carefully and thoughtfully managed. The Committee therefore recommends:

That the Department of Citizenship and Immigration and the Immigration and Refugee Board together develop a strategic plan to manage the transition period between the current refugee claims processing system and any new system that may be implemented. Such a plan should aim, among other things, to limit any negative effect upon efficiency and effectiveness that such a transition may produce.

Lastly, the Auditor General informed the Committee that no one in the federal government monitors the overall progress of claims. He also indicated that there is no information provided to Parliament on interdepartmental performance in processing refugee claims. These are shortcomings that should be corrected. The Committee therefore recommends:

That the government create a mechanism for monitoring the overall progress of refugee claims and reporting interdepartmental performance in claims processing to Parliament.

Conclusion

While the audit revealed problems with the claims processing system, it is important to note that Canada has gained world-wide recognition for its refugee protection program. The Committee also recognizes the dedication and hard work of those currently operating the system who are committed to its goals and effectiveness. Nevertheless, it is important that shortcomings be addressed and past successes be improved upon for the future. It is also important that Canadians have confidence in the system and that the system treats claimants fairly and with compassion.

The Committee is confident that with measures taken following consultation on the Advisory Group's report and with the adoption of the Committee's recommendations and those of the Auditor General, improvements to the processing of refugee claims will occur and the confidence of Canadians assured.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

Dissenting opinions of the Official Opposition and the Bloc Québécois are appended to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 15, 18 23, 28 and 30)* is tabled.

Respectfully submitted,

John Williams

Chair

Dissenting Opinion of the Official Opposition for the Standing Committee on Public Accounts

Pursuant to Standing Order 108(3)(e), the Official Opposition Members of the Standing Committee on Public Accounts have the honour to present their Dissenting Opinion as an addendum to:

NINTH REPORT

It is the opinion of the Official Opposition that the Report of the Standing Committee on Public Accounts is not representative of the opinions and recommendations of the entire Committee, but rather that of the Government members.

Introduction

"The current system is open to abuse and, in general, does not provide swift protection to those who really need it."¹

The purpose of this report is not to delve into partisan debate over the findings of the Auditor General (AG), but rather to use these findings to better expedite those who are in genuine need of Canada's protection. It is the opinion of the Official Opposition that this objective was adhered to in the broad context of the Committee Report. However, in instances where constructive analysis and criticism were required, the government members seemed more focussed on damage control and public relations.

The Official Opposition also recognizes that the Standing Committee on Citizenship and Immigration is presently undertaking an in-depth analysis of the Legislative Review Advisory Group's Report entitled *Not Just Numbers*. Therefore, this dissenting opinion will focus on the broad-based, systemic problems outlined in the AG Report and leave the technical detail to those studying the legislative review.

Receiving Claims

Both the AG and the Committee Report refer to areas of difficulty in receiving refugee claims. The first recommendation, at page 4 of the Committee Report, recommends that the Department "develop a strategy to make the initial examination of claims more rigorous...."

It is the opinion of the Official Opposition that the Government must put an end to the rampant abuse of economic immigrants trying to get into Canada through the refugee system and start accepting more genuine refugees through offices abroad.

Further, we believe that the Government should enforce tighter identification standards on those claimants who fail to produce travel documents.² This strategy should also stop those people who have come to Canada through safe third countries like the United States from making claims here.³

The Committee Report notes the importance of Canada's "world-wide recognition for its refugee protection program." The Government members of the committee defeated a motion to insert the following statement after the

¹ Press Release, Office of the Auditor General of Canada, December 1997 - Chapter 25

² *Report of the Auditor General of Canada - December 1997*, pp. 25-14 - 25-17

³ *Ibid.*, pp. 25-17 - 25-18

aforementioned sentence: "Future emphasis should be focussed on the resettlement of genuine U.N. Convention refugees." The Official Opposition feels that this emphasis would better represent the Auditor General's observation that:

The current process does not quickly grant Canada's protection to claimants who genuinely need it. Furthermore, it does not discourage from claiming refugee status those who do not require or deserve Canada's protection.⁴

The Official Opposition implores the Department of Citizenship and Immigration to seek out genuine Convention refugees overseas whose lives are in imminent danger and are without the financial means of finding asylum here in Canada.

Processing of Refugee Claims

The Committee Report recommends increasing the length of Immigration and Refugee Board (IRB) members' terms and reviewing past performance before re-appointments are granted. Although the Official Opposition concurs with this sentiment, we feel that this recommendation does not address the recruitment and selection of members.

The Auditor General stated, "*Board members must make complex decisions that could have a major impact on the life, liberty or security of the claimant and on the integrity of the system—an impact that makes their role akin to that of a court judge.*"⁵

It is the opinion of the Official Opposition that the recruitment and selection of IRB members is inadequate given the responsibilities inherent to the job. There have been some very competent appointments to the IRB; however, in our opinion, these are the exception rather than standard practice. The majority of the appointments made to the Board are based on political patronage, rather than knowledge or experience. In reference to Board members, the Auditor General stated, "*There must never be any doubt about their competence or their independence.*"⁶

The Ministerial advisory committee was created to recommend appointees to the Minister in order to remove any allegations of patronage. The problem that has arisen, as reported by the IRB founder, Mr. Gordon Fairweather, is that non-Liberal recommendations, regardless of credentials, are overlooked in favour of appointing those who also happen to be Liberals.⁷

The Auditor General made the following observation on the handling of failed refugee claims:

Citizenship and Immigration Canada is having difficulties in resolving failed refugee claims quickly and efficiently. The review of risk of return contains ambiguities that raise questions about its merit. We also found a lack of rigour in the assessment of humanitarian grounds for allowing failed claimants to remain. Further, the Department is having serious difficulties carrying out removals.⁸

⁴ *Ibid.*, p. 25–34

⁵ *Ibid.*, pp.25–18 - 25–19

⁶ *Ibid.*, p. 25–19

⁷ *The Ottawa Sunday Sun*, February 8, 1998

⁸ *Report of the Auditor General of Canada - December 1997*, p. 25–5

To this end, the Official Opposition proposes that the Government involve all law enforcement agencies to clean up our deportation mess. As is stated in the majority report, the Auditor General revealed that, of 19,900 removal orders since 1993, only 22% (4,300) of the departures could be confirmed.⁹

Canadians have lost faith in the immigration system due to the Government's rampant patronage, perceived incompetence and inability to remove those who have been ordered to leave Canada.

Conclusion

The Official Opposition holds a fundamentally different view on the Immigration and Refugee Board than the Government. We would replace the patronage-ridden, unaccountable IRB with well-trained immigration officers accountable to Parliament and Canadians.

While we realize that it is not within the Government's best-interest to end the patronage-appointment process, we fail to understand why they seem uninterested in promoting better accountability, effectiveness, and efficiency when discussing the reform of the Board.

A case in point is the Government members' adoption of a motion to remove the word "widespread" from the draft of the Committee report, which had formerly stated, "...the [AG] audit revealed widespread problems with the claims processing system."

This example emphasizes the Government members' mandate of making reference to the Auditor General's recommendations while removing any language which might be seen to damage themselves.

Rather than an educated assessment of the Auditor General's report, the Committee report amounts to a public relations piece for the Board, the Department and the Government as a whole.

The conclusion of the Committee Report makes brief references to "problems" and "shortcomings" before moving on to recognize "the dedication and hard work of those currently operating the system who are committed to its goals and effectiveness."

The Official Opposition is committed to representing grassroots Canadians and to restoring their faith in an immigration system that works for them. For this to occur, the Government must recognize and remedy the widespread problems revealed by the Auditor General in several reports, including Chapter 25 of his December 1997 Report.

⁹ *Ibid.*, p. 25–29

Dissenting Opinion to the Ninth Report of the Standing Committee on Public Accounts

Respectfully submitted by :

Odina Desrochers, M.P.

René Laurin, M.P.

Despite the lip-service that the Liberal majority report pays to making the Immigration and Refugee Board (IRB) speedier and more efficient in its processing of refugee claims, the Bloc Québécois considers that the problems cited by the Auditor General will remain unresolved unless and until candidates for the Board are chosen for their qualifications rather than their party loyalty.

In 1993 the Liberal Party criticized the Conservatives' political appointments to the IRB, but the Jean Chrétien government is doing exactly the same thing.

Here is the commitment the Liberal Party made in 1993 on Cabinet appointments :

"The Conservatives made a practice of choosing political friends when making the thousands of appointments to boards, commissions and agencies... To fill the vacancies that remain, a Liberal government will review the appointment process to ensure that necessary appointments are made on the basis of competence." (Red Book, p. 92)

The reality, since the Liberals came to power, has been instructive. They have never stopped making political appointments to the IRB.

The Bloc Québécois has on many occasions called on the Liberal government to introduce an appointment process that would ensure complete impartiality and a selection based on candidates' competence and professional experience.

The last paragraph at page 8 of the majority report could be very timely, as long as the second paragraph at page 4, which deals with general principles, is made more specific. The Bloc Québécois would like the "targets and deadlines" to be defined, with a clear and detailed timetable : this would enable Parliament to really monitor the proposed changes and ensure that they do in fact improve the IRB's processing of refugee claims.

REPORTS TO THE HOUSE

Tuesday, 12 May 1998

Management of the Small Business Loans Program

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

TENTH REPORT

The Standing Committee on Public Accounts has considered Chapter 29 of the December 1997 Report of the Auditor General of Canada (*Industry Canada – Management of the Small Business Loans Program*) and the Committee has agreed to report the following:

Introduction

Small businesses constitute the overwhelming majority of all business establishments in Canada and contribute significantly to the nation's economic output and employment.

Lack of financing under reasonable terms and conditions is considered a serious impediment to small business expansion. Consequently, governments in industrialised countries have often played a complementary role to private lending institutions either as direct providers of capital financing or to secure access to financial capital through loan guarantees, usually with the objective of promoting economic growth and employment.

In recognition of the contribution of small businesses to the dynamism of the Canadian economy, the Federal government delivers several programs designed to promote and stimulate small business development and growth. The *Small Business Loans Act* (SBLA) program, administered by Industry Canada and delivered through private financial institutions, is one of these federal programs.

Recent amendments to the *Small Business Loans Act* have resulted in significant increases in SBLA loan activity and in levels of claims to the Federal government. This sudden surge in program lending activity and claim levels prompted the Auditor General to audit the SBLA program management.

Acknowledging that the associated cost incurred by the SBLA program can become substantial to the Federal Government, the Committee decided to examine Chapter 29 of the Auditor General's December 1997 Report (*Industry Canada – The Management of the Small Business Loan Program*). Accordingly, on February 19, 1998, the Committee met with Mr. Denis Desautels (Auditor General of Canada), Mr. Richard Flageole (Assistant Auditor General), and Mr. Harry A. Ruthnum (Principal, Audit Operations) from the Office of the Auditor General. Mr. Kevin G. Lynch (Deputy Minister), Mr. Peter Sagar (Director General, Entrepreneur and Small Business Office), and Ms. Marie Josée Thivierge (Director, Strategic Planning and Corporate Services) represented Industry Canada.

Background

Established in 1961, the *Small Business Loans Act* (SBLA) encourages private sector lending institutions to make loans of up to \$250,000 to small businesses for the purchase or improvement of land, buildings and equipment. In case of borrower default, the program reimburses the lender 85 percent of the net amount of the loan. The maximum loan loss that can be refunded to individual lenders is limited to 10 percent of total outstanding registered loans.

In 1993, Parliament approved important changes to the SBLA program that simultaneously broadened eligibility requirements, increased maximum loan amounts from \$100,000 to \$250,000, increased the permissible financing from 80 percent to 100 percent for equipment and 90 percent for land and buildings and reduced the personal guarantee requirements. Within two years of these legislative changes, lending activity soared eight-fold from an annual average of \$500 million to \$4.4 billion dollars. Starting with the same period, claims on defaulted loans increased considerably. Because loans may be repaid over a period of ten years and claims may be submitted for a further three years, the impact of loan losses will continue to be felt for a considerable period of time. According to the Auditor General, the program will incur an estimated net loss of \$210 million for loans issued between 1993 and 1995. Since 1993, some 177,000 new loans have been guaranteed for a value of approximately \$11.2 billion. The total amount of guaranteed loans outstanding at 31 March 1997 was \$6 billion, of which the government was contingently liable for a maximum of \$1.4 billion.

In response to increasing risk and cost, legislative changes introduced effective 1 April 1995 modified SBLA program elements to encourage full cost recovery. The amendments were: introduction of an annual fee of 1.25 percent charged to the lender and based on the outstanding balance of loans; a reduction of insurance coverage from 90 to 85 percent of loan value, and the percentage of available financing was decreased from 100 percent to 90 percent (for loans made after 31 December 1995). As a result of these changes, the dollar value of loans issued under the program has dropped into the range of \$2 billion annually. The Auditor General is uncertain whether the objective of full cost recovery is achievable under the present fee structure and loss-sharing ratio, nor if it is at all compatible with the program's fundamental goal of assuring that loans made under the program are complementary to existing lending.

New lending under the Program was supposed to end on 31 March 1998, however Bill C-21, which was passed in the House of Commons on 17 March 1998, extends the application of the *Small Business Loans Act* to 31 March 1999. This one-year extension is to allow Industry Canada to carry out a review and implement changes to the SBLA program.

Observations and Recommendations

The Committee learned of three principal concerns expressed by the Auditor General regarding his review of the *Small Business Loans Act* program. The Auditor General focussed on the lack of clear definition about expected results, weaknesses in the management and delivery of the program, and the provision of information to Parliament, particularly in terms of program objectives, achieved results and job creation data.

Apart from the very broad objective of increasing the availability of loans to small enterprises, the SBLA program lacks a clear statement of objectives and expected results by which one can assess the program's performance and achievement of its stated goals. The SBLA program objective is stated in very general terms, that is "to increase the availability of loans for establishing, expanding, modernising, and improving small business enterprises". The stated objective does not specify how these goals are to be achieved. It is worth noting that when program delivery is delegated to third parties (i.e. private lending institutions) program managers have less discretion in influencing the direction and scope of the program. Nevertheless, program managers would benefit from a more precise definition of expected results that is articulated within a framework of broad legislated objectives. Clearly defined performance criteria are a prerequisite for sound program design, especially in a context of continuous legislative or administrative changes. Therefore the Committee recommends:

That the review undertaken by the Department of Industry develop a set of clearly defined statements of performance and expected results for the SBLA program, and also establish a number of key performance indicators to help evaluate its progress in achieving the stated goals.

The Auditor General is particularly concerned about the degree of the program's loan incrementality, that is the proportion of loans that would not have been made in the absence of the program. In the past five years, the Department commissioned several studies to determine the incrementality of SBLA loans. A 1994 study indicated

that between 30 to 40 percent of SBLA loans were non-incremental. Another study completed in 1996 indicated that 46 percent of SBLA loans competed directly with private sector financing. Since the program's objective is to increase the availability of loans to small enterprises beyond that which would be normally available from private lenders, the Committee believes that it is important to assure the complementary character of SBLA loans in order to avoid waste of scarce capital resources. It therefore recommends:

That the program review establish clear target levels of incrementality for its SBLA loans.

The Auditor General has also noted that while the SBLA program underwent many major changes since its inception in 1961, it is still directed toward the financing of capital assets (land, buildings and equipment). While this type of financing is suitable in an economy dominated by the manufacturing sector, it may not be as suitable in a service economy, particularly for knowledge based industries (KBI) such as computer or software based businesses. Recently, private sector financial institutions have introduced new products and services directed to respond to current financial needs of small business. The SBLA program may require amendment to address any gaps in the private financing of small businesses. Therefore, the Committee recommends:

That during the current review Industry Canada identify gaps in the private financing of small enterprises and redesign the SBLA program in order to supplement current small business financing needs in the market areas where it is determined that government assistance would be beneficial.

Following the 1993 program amendments, a significant increase was observed in both lending activity and in the level of claims on borrower default. As a result of this surge in loan activity and cost, a policy of full cost recovery was implemented after 1 April 1995. This new policy introduced certain changes to elements of the program, such as a decrease of the loan-loss ratio from 90 percent to 85 percent and saw the imposition of a 1.25 percent annual administration fee charged to the lending institution on the average amount of loans outstanding. Industry Canada projected that these measures would eventually lead to full cost recovery over a 10-year period. However, both the Auditor General and the Department have recently reviewed the program's loan guarantee portfolio and observed a significant increase in the proportion of riskier loans and a rise in rates of defaults that are occurring at earlier stages in the life of the loans. The Auditor General feels that program managers should take into account the impact of a riskier portfolio and the business cycle when making default rate projections. The Auditor General believes that under the current fee structure and loss sharing ratio, it is uncertain that full cost recovery will be achieved. As a result, the Committee recommends:

That the Department closely monitor any developments in the performance of its guaranteed loan portfolio that might prevent it from achieving full cost recovery and that it take corrective action at an early stage.

The Auditor General recommended in paragraph 29.52 of his Report that the Department needs to further develop systems and procedures to forecast the future performance of its guaranteed loan portfolio. The Committee heard the testimony of the Department's Director of Strategic Planning and Corporate Services, Ms. Marie-Josée Thivierge, regarding the progress in the development of the required systems and procedures to forecast program performance. Noting the progress already achieved, the Committee therefore recommends:

That the current review establish systems and procedures to forecast program performance for portfolio management and to take early corrective action if necessary.

The program is structured in such a way that the responsibility of credit risk management and compliance to SBLA provisions are delegated to the lending institutions. The expectation is that lenders will ensure that all loans made under the program are in compliance with the SBLA eligibility requirements and conditions and that lending decisions under the program are made with the same due care and diligence as with non program loans. The Department itself obtains assurance of the quality of credit risk and compliance to the Act by focussing on claims submitted for payment.

The Auditor General is concerned whether the systems and procedures in place are sufficient to ensure that loans made under the program comply with SBLA provisions. He examined the lenders' loan files and noted that in certain cases some files contained insufficient information to perform a thorough analysis of credit risk. In other instances, financial institutions had charged, contrary to the Act, extra administration fees for granting loans under the program. Additionally, it was observed that in some other cases the Department did not request full and complete information on the loan files when assessing a claim. In such cases, there is greater risk of accepting claims that may not be in compliance with the provisions of the Act. To minimise the risk associated with non-compliant loans, the Committee recommends:

That the Department obtain and review all bad loan files to ensure lender's compliance with the provisions of the Small Business Loans Act.

The Department told the Committee that it acknowledges certain of the Auditor General's concerns about the compliance of financial institutions to the provisions of the Act and assured the Committee that it will address these concerns in its upcoming review. However, the Department felt that the processes and systems already in place were sufficient to detect most irregularities and that the potential rejection of a claim request was deemed a sufficient deterrent to ensure that lenders apply due care and diligence in making loans under the SBLA program. Nevertheless, the Committee feels that the Department could exert more effort to further reduce the risk of accepting non-compliant loans by increasing its monitoring of financial institution's lending practices. Therefore the Committee recommends:

That in order to ensure better lenders' compliance with SBLA provisions , the Department implement measures to increase monitoring of financial institutions lending practices such as securing better access to lender's loan files and undertaking sample audits of lender's loan portfolio.

The Auditor General's sample audit of the lender's loan portfolio also identified cases where related borrowers were able to obtain loan amounts far in excess to the \$250,000 limit per business. In one case, 23 related borrowers managed to obtain more than \$4 million in loans. While these practices are contrary to the intent of the Act, the Auditor General noted that there are currently no provisions under the SBLA to prevent a group of entities with substantial common ownership from gaining multiple access to loans under the program. Such rules do exist under the *Income Tax Act*, which has provisions designed to limit access to the low corporate rate of tax for small businesses and to prevent abuse by the creation of related corporations. The Auditor General stressed the importance of clarifying this issue in order to ensure that the Program meet its intent of providing financial assistance to small enterprises within acceptable level of risk exposure to the government. The Department responded to this question by sending in a Notice to Lenders in May 1996 to address this specific issue and is proposing to introduce amendments to the Act during its upcoming review. At the same time, the Department feels that the actions it has already taken have sufficiently clarified the Act's provisions so that there is no longer any room for misinterpretation by lending institutions regarding access to loans by related entities. The Committee recognises the Department's current efforts to resolve this issue, and urges it to continue to take steps in removing all ambiguity in the interpretation of the provisions of the Act. Therefore, the Committee recommends:

That the Department use the opportunity offered by its program review to further clarify the provisions in the SBLA by providing amendments to the Act with regards to loans to related entities.

The Department reports to Parliament on the *Small Business Loans Act* program primarily through Part III of the Estimates and the Minister's annual report. The Auditor General assessed these documents in terms of their information content and concluded that better data could be provided especially in the areas of performance indicators and job creation data.

While these documents do provide some useful information in describing the context under which the SBLA program operates, the Auditor General concludes that they do not contain enough information to assess the program's ability to attain its stated objectives or if it is managed efficiently.

The Auditor General feels that the absence of clear program objectives hinders the Department's ability to find suitable performance indicators to assist in the evaluation of the SBLA program. Given the stated goals of incrementality and full cost recovery, proper evaluation would require information on revenues, administrative and claims expenditures, and a provision for loan losses. The information should also be presented on accrual basis. In 1997, the Department implemented a new information system which would provide additional information on program results such as lending activity by types of lenders, by provinces, by size of business enterprises, as well as claim activity levels, management program costs and revenues, and Minister's liability on outstanding loans. The Committee urges the Department to continue efforts in this vein, and thus recommends :

That the Department use the opportunity provided by the program review to establish a comprehensive system of performance reporting to Parliament including a set of performance indicators.

The Department also reports on the number of jobs created as a result of the program. In its 1995–96 Annual Report, the Department reported that 81,600 jobs had been created as a result of the program. The Department gets job creation data through a survey of loan guarantee registration forms that is prepared by lending institutions. The Auditor General finds this approach of reporting job creation as being too simplistic because the information on jobs created is based on the borrowers own labour projections which might overstate the number of jobs actually being created. The Auditor General cites economic studies undertaken by the Department itself which suggest that the actual employment gains resulting from the SBLA program is far smaller than the ones indicated in the annual reports. The Auditor General feels that the Department should apply a more rigorous methodology to properly evaluate the employment impacts of the SBLA program. Also, there are questions raised about placing too much emphasis on employment growth as a justification of the SBLA program. Loans that can augment small business performance such as the introduction of new technology can improve its competitive position or cost structure but can also result in temporary job losses as new technology or processes displace workers. The Committee shares the Auditor General concerns and therefore it recommends:

That in the current review, the Department re-examine its existing systems and procedures in order to develop a more rigorous methodology in evaluating the job impacts of the SBLA program.

Conclusion

The *Small Business Loans Act* program provides assistance to the small business sector in Canada but the audit revealed certain shortcomings in its design, operations and reporting to Parliament and these need to be addressed. The Program, scheduled to terminate in 31 March 1998, was given a one year extension in order to complete a thorough review of its stated objectives, designs and operations.

The Committee is confident that the adoption of its recommendations and those of the Auditor General, will assist the current review of the *Small Business Loans Act* program, and that improvements will occur and assure better assistance to small enterprises throughout Canada.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings* (*Meetings Nos. 19 and 30*) is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Friday, 15 May 1998

Correctional Services – Custody of Inmates

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

ELEVENTH REPORT

The Standing Committee on Public Accounts has considered Chapter 35 of the December 1997 Report of the Auditor General of Canada (*Follow-up of Recommendations in Previous Reports – Correctional Services – Custody of Inmates*) and the Committee has agreed to report the following:

Introduction

In his 1994 Report, the Auditor General presented the results of his audit of Correctional Services Canada's (CSC or the Service) activities with relation to the custody of inmates. The Standing Committee on Public Accounts held hearings on the audit results and presented its 13th Report containing observations and recommendations to the House of Commons on 15 June 1995. Correctional Service Canada's response to both the Auditor General's Report and the Committee's Report was generally positive.

Subsequently, the Auditor General conducted a follow-up review of the progress made by CSC in implementing both his and the Committee's recommendations. The results of this follow up were presented in Chapter 35 of his December 1997 Report.

The way in which CSC manages custody of inmates in Canada's penitentiaries has a profound impact on Canadian society and involves the safety of individuals, communities, those who work in the prison system, and those who are incarcerated within it. As a consequence of this and of Committee's past interest, the Committee decided to examine the results of the Auditor General's follow-up review. Accordingly on 2 April 1998 it met with Mr. L. Denis Desautels, the Auditor General of Canada, Dr. Maria Barrados, Assistant Auditor General, and Mr. Robert Chen, Director of Audit Operations, from the Office of the Auditor General. Mr. Ole Ingstrup, Commissioner, and Ms. Lynn Balice, Director, Ministerial Liaison, represented Correctional Service Canada.

Observations and Recommendations

The Committee learned that Correctional Service Canada has carried out a number of initiatives in response to the Committee's recommendations and those of the Auditor General. In terms of accommodation planning, the Service's response was appropriate. In accordance with recommendations, it has begun to use cost-benefit analysis when it evaluates future accommodation projects. It now incorporates double-bunking and shared accommodation strategies in its accommodation planning. It has also appointed a full-time senior executive responsible for all functions that are related to accommodation. The Committee welcomes the progress made in these areas.

Progress with regard to security classification, however, has not been all that was hoped for. Security classification is a vital part of what the Service does and takes place in two steps. When an offender is taken in to the system, he or she is assessed using the Service's Custody Rating Scale (CRS) to determine level of risk they pose to security. Subsequent to this initial assessment, the inmate is reclassified on an annual basis using the Service's Security Classification Review.

The information generated by these assessments is used to assign the inmate to either a maximum-, medium-, or minimum-security facility. If the assessment is not exact, the inmate may be assigned to an institution with a higher degree of security than is necessary. This results in higher incarceration costs. If the reverse happens and a high-risk offender is assigned to a lower-security institution, then public safety is put at risk. Occasionally, an inmate may be deliberately accommodated in a facility that does not match his or her assessment. This is known as an 'override' and may happen for a legitimate reason such as a desire to house the inmate close to his or her family. At other times, however, overrides can occur without a legitimate reason. When overrides exceed 15 to 20 percent, it is commonly agreed that management must decide whether the method of security assessment needs to be changed or if staff need additional training.

Although CSC has made improvements, the Auditor General reported that a 1996 study by the Service found a 26 percent override rate. Only about half of the overrides were for legitimate reasons. Despite the Committee's recommendation that the Service monitor overrides regularly, CSC was unable to report the number of and reasons for overrides until December 1997. Mr. Ingstrup told the Committee that in its first monitoring report covering the period ending 22 February 1998, the Service found that 53% of the time, its officers were overriding the Scale to place inmates in medium-security institutions when they had been classified as maximum-security.

The Commissioner argued, however, that the high rate of overrides occurred because the Custody Rating Scale did not reflect reality. Correctional staff were thus obliged to override some of the ratings produced by the Scale in order to ensure that inmates were assigned to the correct facilities. No increase in the rate of escape, he asserted, proved that decisions to override the Scale were appropriate. In addition, the Commissioner asserted that overriding the Scale had not resulted in problems in the correctional institutions. Based on these conclusions CSC is adjusting the Scale to bring it into line with reality and expects to complete this work sometime in 1998.

In addition, the Service estimates that it will only be able to implement new, more objective, reclassification methodology — currently being tested — by the end of 1998. As a consequence of the changes being made to the CRS and the reclassification instrument, CSC estimates that it should be able to reduce overrides to a rate of 15 percent sometime in 1998.

Mr. Ingstrup told the Committee that delays in implementing these changes were unacceptable but declined to offer any explanation. In light of the role played by classification in promoting public safety and keeping costs within reason, the Committee finds these delays regrettable. It therefore recommends:

That Correctional Service Canada adhere to the schedule it has established for adjusting its Custody Rating Scale and fully implement a quantitative, objective reclassification instrument and keep the Committee advised of the progress being made in both areas.

Furthermore, the Committee recommends:

That Correctional Service Canada regularly monitor the application of its classification instruments and the results generated. In particular, the Service must monitor the use of overrides and report the results to Parliament;

That Correctional Service Canada periodically revise its classification instruments in order that they reflect actual experience;

That Correctional Service Canada establish and make public a deadline for attaining its target override rate of 15 percent; and

That Correctional Service Canada regularly consult with and train its staff regarding the use of the Custody Rating Scale, the reclassification instrument, and the valid use of overrides.

In its 13th Report, the Committee expressed its concerns about double bunking. The Committee was therefore pleased to hear the Commissioner state clearly that double occupancy (which includes double bunking) is 'inappropriate as a permanent accommodation measure within the context of good corrections.' Contrary to what might be assumed, costs associated with this form of accommodation are higher — not lower. For example, Mr. Ingstrup agreed that double bunking generally requires increased staffing. This may also result in the reallocation of funds needed to support programs that facilitate the movement of inmates to lower - security — and thus lower-cost — institutions. If transfers are delayed because program requirements have not been met, costs are kept higher than need be. It therefore makes sense in terms of both rehabilitation and cost to eventually eliminate this practice.

Mr. Ingstrup told the Committee that CSC hopes that by implementing some of the Auditor General's other recommendations the incarcerated population will be lower thus reducing double occupancy or double bunking from the current level of 25 percent. During testimony he indicated that the Service hopes to attain a reasonable level of double occupancy and 'potentially get rid of double bunking altogether.'

The Committee notes that CSC is currently reviewing its accommodation policy and recommends:

That Correctional Service Canada establish, within the context of its review of accommodation policy, what constitutes a reasonable level of double occupancy, that it establish an estimated date for ending the practice of double bunking, and that it clarify its policy on shared accommodation.

Conclusion

At the end of his testimony, the Auditor General indicated that he was quite pleased with the actions taken by Correctional Service Canada. The Committee acknowledges that progress has been made in addressing the concerns and recommendations that it made in 1995. There are, however, several areas in which progress has not been as complete or timely as the Committee would have liked. The Committee expects that Correctional Service Canada will meet the commitments that it has made and will finish the task of improving security classification and accommodation policies. This will result in a penitentiary system that is safer, more efficient, and better able to achieve the correctional goals that have been set for it.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 26 and 31)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Friday, 15 May 1998

Revenue Canada and Department of Finance Understanding Changes in Tax Revenues: GST

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

TWELFTH REPORT

The Standing Committee on Public Accounts has considered Chapter 32 of the December 1997 Report of the Auditor General of Canada (*Revenue Canada and Department of Finance — Understanding Changes in Tax Revenues: GST*) and the Committee has agreed to report the following:

Introduction

The ability of the Federal Government to fully account for tax revenue fluctuations is critical for the identification of errors and increases its awareness of new economic trends. It also enhances the credibility of the Government's financial reporting to Parliament and improves its ability to forecast tax revenues, budgetary deficits and borrowing requirements.

The Auditor General has observed that monthly Goods and Services Tax (GST) revenues fluctuated significantly over time and with no apparent pattern. It was further noted that GST revenues for the year ended 31 March 1996 turned out to be \$800 million lower than the 6 March 1996 Budget forecast, and \$400 million lower than the previous year's actual revenue. The Auditor General is of the opinion that Revenue Canada and the Department of Finance ought to be better able to understand and explain such fluctuations in tax revenue streams.

Because of the importance to the Federal government of being able to fully account for and explain revenue fluctuations, the Committee decided to examine Chapter 32 of the Auditor General's December 1997 Report. Accordingly, on 17 March 1998 the Committee met with Mr. Denis Desautels (Auditor General of Canada), Mr. Shahid Minto (Assistant Auditor General), Mr. James Ralston (Principal, Audit Operations), Mr. Scott Milne (Principal, Audit Operations) and Ms. Basia Ruta (Principal, Audit Operations) from the Office of the Auditor General. The following represented Revenue Canada: Mr. Robert A. Wright (Deputy Minister), Mr. Dan Tucker (Assistant Deputy Minister, Finance and Administration Branch), Mr. John Kowalski (Director General, Audit Directorate), Mr. Bill Boston (Director General, Financial Administration Directorate, Financial and Administration Branch), Mr. David Miller (Assistant Deputy Minister, Assessment and Collections Branch), Mr. Brian Brimble (Interim Director General, Operational Policy and Co ordination Directorate, Customs and Trade Administration Branch), Mr. Paul Godden (Interim Director, Program Support Division, Operational Policy and Co ordination Directorate) and Mr. Stephen Rigby (Director General, Corporate Affairs Branch). Mr. Peter DeVries (Director, Fiscal Policy Division) and Mr. Paul-Henri Lapointe (Assistant Deputy Minister, Fiscal and Economic Policy) represented the Department of Finance.

Observations and Recommendations

The Auditor General informed the Committee that the total GST revenues collected for the year ending 31 March 1996 was the \$800 million less than the amount predicted by the 6 March 1996 forecast, and \$400 million

lower than the previous year actual revenue. The Auditor General mentioned the Department of Finance and Revenue Canada's attempt to identify the contributing factors responsible for the GST revenue shortfall and concluded that both Department failed to provide a conclusive and adequately documented explanation.

The Auditor General believes the federal government's ability to ascertain the cause (or causes) responsible for revenue fluctuations can be improved if it follows an appropriate five step process for analysing movements in revenue streams. The audit found that the Department of Finance and Revenue Canada did not follow this process to the minimum extent required, nor did they make use of all available data. Some of the unused data were considered unreliable.

The Auditor General also mentioned other items that were affecting the analytical capability such as a need for a better co-ordinated effort within Revenue Canada: the limited amount of information reported on GST returns; and the way Revenue Canada records figures for "GST declared" and "input tax credits".

The Assistant Deputy Minister of the Department of Finance, Mr. Paul-Henri Lapointe, while agreeing with the Auditor General's recommendations for improving the timeliness and the reliability of GST data, nonetheless disagreed with the Auditor's assessment that the analysis was inconclusive and that both Departments failed at carrying out the appropriate analytical process. Finance's analysis pointed to several factors which could have contributed to the forecast variance. First, economic data used for analytical purposes come with considerable time lags and are subject to revisions well after the fact. This alone was estimated to represent \$500 million of the \$800 million GST revenue shortfall. Second, Revenue Canada identified a further \$245 million of the shortfall that was due to bookkeeping adjustments. Finally, other contributing factors identified were time lags between receipt of GST collections and payments of refunds and rebates, and changes in receivables.

In his opening statements, the Deputy Minister of the Department of Revenue, Mr. Robert Wright, did not make any specific statements on GST revenue fluctuations with the exception that the Revenue Canada will continue to collaborate with Finance in the Fiscal Monitor Committee to address revenue analysis issues. When the Committee members questioned Mr. Wright about Revenue Canada's adherence to the five step analytical process, the witness responded that Revenue Canada generally followed the recommended five step process and mentioned an offer to collaborate with the Auditor General towards improving the Department's execution of the analytical process. Revenue Canada's Director General of the Financial Administration Directorate, Mr. Bill Boston, concurred with Mr. Wright's statements, that Revenue Canada substantially, but not fully, followed the recommended process. While the Committee recognises Revenue Canada and the Department of Finance's efforts at fully accounting for revenue changes, it agrees with the Auditor General that closer adherence to the recommended process will enhance each Department's ability to analyse revenue streams. Therefore, the Committee recommends:

That both Departments set an action plan and timetable in order to meet with the Auditor General to find ways of ensuring that the five step analytical process is fully and thoroughly adhered to and carried out.

The Auditor General mentioned in his report on the importance of improving the reliability and the timeliness of the data, and making better use of them would improve Revenue Canada and Finance's ability to analyse GST movements, it may not be enough. Additional registrant information might be required (32.35). The Assistant Deputy Minister of the Department of Finance, Mr. Paul-Henri Lapointe, agreed with the need to improve the reliability and timeliness of tax data but this requirement had to be balanced against the need to minimise any additional burden to the tax registrant. Committee members expressed similar reticence at imposing additional cost and administrative burden to registrants. Mr. Shahid Minto, Assistant Auditor General, agreed with the concerns expressed by the Committee and proposed one way of obtaining supplementary information without adding to registrant burden. The method consists of simply amending the GST return form so that the information contained in the working copy is transferred to the detachable portion of the form that is submitted to Revenue Canada (Exhibit 32.3) This leads the Committee to recommend:

That both Departments continuously explore ways of improving reliability and timeliness of revenue information with a equal concern of avoiding undue cost and administrative burden to tax registrants.

In a related question, the Committee enquired if Revenue Canada had enough information to administer the GST. In response, the Department's Deputy Minister, Mr. Robert Wright, assured the Committee that it had sufficient data to administer the GST and would like enough information to carry out cross checks to improve data reliability but did not recommend asking for additional information from taxpayers for purely analytical purposes. Mr. Wright went on to say that the current re-engineering of processes at Revenue Canada, which includes the standardisation of accounting systems, expected to be concluded by year 2002, and the move towards accrual basis of accounting, will provide further opportunities to improve monitoring and analysis of revenue streams. The Committee therefore recommends:

That both Departments in co-operation with the Auditor General, investigate ways to obtain more information on GST collection without imposing additional cost and administrative burden to tax registrants. And that Revenue Canada complete its transition towards standardised accounting systems and accrual basis of accounting as a further means of verification and validation of revenue data.

The Committee also enquired about the level of co-ordination between Finance and Revenue Canada in terms of analysing GST revenue fluctuations and whether both Departments has similar co-ordination arrangements for other revenue streams. The Department of Finance's Deputy Minister, Mr. Paul-Henri Lapointe, assured the Committee that both Departments work closely together in analysing *all* revenue streams through their Fiscal Monitor Committee. Furthermore, there are regular consultations with their provincial counterparts to assess the current fiscal situation of the provinces as well to identify events that might have serious impacts on national revenue. In light of this, the Committee recommends:

That both Departments seek further opportunities to better co-ordinate their efforts to improve their capability to analyse all revenue streams and also seek to improve the consultation process with the provinces to better identify issues that may be relevant in analysing national revenue streams.

Conclusion

The Committee shares the concerns expressed by the Auditor General concerning Revenue Canada and Finance's ability to thoroughly analyse GST revenue fluctuations. While recognising the continued efforts of both Departments in explaining changes to revenue streams, it is felt that further action on their part could be pursued in order to assure the completeness of the analysis. Particularly, both Departments should follow more closely the five-step process the Auditor General recommended for analysing GST revenue movements. Moreover, to the extent that revenue analysis is still hampered by unreliable and untimely data, Finance and Revenue Canada should therefore continue to develop better processes in obtaining, verifying and validating the required information.

The Committee appreciates the forthrightness of the witnesses from the Departments of Finance and Revenue, and commends them on their willingness to take action on the concerns and recommendations of the Auditor General.

The Committee is confident that the adoption of its recommendations and those of the Auditor General will assist Revenue Canada and Finance in its efforts to improve their joint ability to fully analyse revenue fluctuations.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 22 and 31)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Friday, 15 May 1998

Revenue Canada The Financial Management Regime

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

THIRTEENTH REPORT

The Standing Committee on Public Accounts has considered Chapter 31 of the December 1997 Report of the Auditor General of Canada (*Revenue Canada – The Financial Management Regime*) and the Committee has agreed to report the following:

Introduction

Few federal organisations can compare with Revenue Canada in terms of size and range of financial transactions. With a workforce of over 40,000 employees in approximately 800 offices across Canada, its activities support most federal government programs and expenditures, and via transfer payments, provides funding to assist provincial governments in delivering their programs and meeting their commitments. On a daily basis, Revenue Canada collects about \$850 million in taxes and disburses \$425 million in the form of various refunds and credits. In the execution of its mandated responsibilities Revenue Canada must perform innumerable financial transactions and follow multitudinous accounting procedures across the width and breadth of its organisation.

Given the enormous size of the financial operations involved, minor discrepancies, errors and missed opportunities at correcting inefficiencies can result in potentially significant and cumulatively huge amounts of foregone tax revenues. Given the scope of its activities and the importance of Revenue Canada's ability to meet its mandated responsibilities, the Department must show a clear and strong commitment to effective financial management and control of expenditures, revenues and assets.

Because of the crucial importance of an effective financial management regime to the integrity and effectiveness of Revenue Canada operations, the Committee decided to examine Chapter 31 of the Auditor General's December 1997 Report. Accordingly, on 17 March 1998 the Committee met with Mr. Denis Desautels (Auditor General of Canada), Mr. Shahid Minto (Assistant Auditor General), Mr. James Ralston (Principal, Audit Operations), Mr. Scott Milne (Principal, Audit Operations) and Ms. Basia Ruta (Principal, Audit Operations) from the Office of the Auditor General. The following represented Revenue Canada: Mr. Robert A. Wright (Deputy Minister), Mr. Dan Tucker (Assistant Deputy Minister, Finance and Administration Branch), Mr. John Kowalski (Director General, Audit Directorate), Mr. Bill Boston (Director General, Financial Administration Directorate, Financial and Administration Branch), Mr. David Miller (Assistant Deputy Minister, Assessment and Collections Branch), Mr. Brian Brimble (Interim Director General, Operational Policy and Coordination Directorate, Customs and Trade Administration Branch), Mr. Paul Godden (Interim Director, Program Support Division, Operational Policy and Coordination Directorate) and Mr. Stephen Rigby (Director General, Corporate Affairs Branch). Mr. Peter DeVries (Director, Fiscal Policy Division) and Mr. Henri Paul Lapointe (Assistant Deputy Minister, Fiscal and Economic Policy) represented the Department of Finance.

Observations and Recommendations

The Committee learned from Auditor General that Revenue Canada's financial management regime was basically sound with some areas of strength and no areas of neglect. It was also noted there were still some areas in

need of improvement. Revenue Canada scores well in aspects of strategic planning and enhancing management accountability, but many of its financial systems are weak and require considerable modernising.

The Auditor General's Report examined Revenue Canada's ability to meet its two key fiduciary responsibilities: to ensure the prompt deposit of taxpayer remittances, and to report tax revenues to central agencies.

Prompt bank remitting is important because it avoids paying interest on short-term borrowing or can earn interest by investing surplus funds. The Auditor General noted discrepancies (31.27) between revenue streams in terms of deposit remittance rates. The unevenness in remittance rates is in part due to some revenue streams having provisions for mandatory bank remittance (e.g. source deductions and domestic GST), while other tax revenues (e.g. Customs payments, GST on imported goods, excise levies and duties) are not legally required to be deposited in financial institutions. An additional reason for differences in remittance rates is that not all revenue streams have legislative provisions imposing financial penalties (31.27) on those tax filers who fail to remit tax monies to financial institutions.

Since the administrative consolidation of Customs and Excise with Taxation, Revenue Canada has been active in suggesting legislative changes to harmonise legal provisions across all revenue streams. Proposals for harmonising are in the hands of the Department of Finance. The Committee agrees with the Auditor General that the harmonisation of mandatory bank remittances provisions across all revenue streams will improve the Revenue Canada's cash management and ensure fairer and more equitable treatment of all taxpayers. The Committee therefore recommends:

That legislative amendments be implemented to ensure all revenue streams are subject to the same mandatory bank remittance provisions. In addition, that financial penalty provisions for failure to remit tax monies be applied across all revenue streams.

The Auditor General stated that there is a strong incentive to ensure timely and prompt remittance of tax receipts because it could result in millions of dollars in additional interest revenue or, alternatively, in savings on interest expense for the government each year. The Auditor General's Report noted (31.31) that while Revenue Canada has an established policy for all its offices and ports of scheduling bank deposits if the total daily receipts exceed \$500 dollars, the policy remains vague in terms of timeliness of bank remittance. The Audit revealed that Customs offices have no clear expectation of results for the timeliness of deposits (31.31). As for the rest of the Department, according to the Auditor General, there is a policy of remitting tax monies within 24 hours and maximisation of same day deposits but no performance targets are provided for same day deposits.

The Auditor General assessed Revenue Canada for its timeliness of deposits and found the remittance performance generally satisfactory (31.33) with the majority of tax receipts being promptly deposited on the next business day. But the performance varied considerably by type of revenue stream, by office and by month (31.34). There exist considerable opportunities to improve the promptness of depositing. The Department agrees with the Auditor General's findings and has already taken measures to reinforce effective cash management both at its headquarters and at the regional levels. The Department's Deputy Minister, Mr. Robert Wright, told the Committee that the Department has recently introduced a standard of 100 percent of all remittances within 24 hours and that all significant exceptions will be reported to the responsible assistant deputy minister. Further, Revenue Canada has taken steps to clarify performance requirements to ensure that no ambiguity remains as to the interpretation of performance standards for same day depositing. The Committee shared the concerns expressed by the Auditor General with regards to the timeliness of depositing tax receipts and also acknowledged the Department's current efforts to correct this and thus recommends:

That the Department complete and follow through with all haste and diligence its new policy of full and complete remittance of tax monies within 24 hours and proceed with the clarification of the interpretation of performance standards for same day remittances.

The Auditor General informed the Committee that financial management systems, procedures and practices in place at Customs and Excise did not efficiently support the \$18 billion in cash receipts it processed annually (31.37). The Auditor General observed no same day deposits for the Customs office included in the sample audit (31.35). Customs has yet to clearly establish a standard of performance for promptness of its deposits. The Audit found Custom's national deposit system archaic, labour intensive, slow and prone to error. Departmental witnesses agreed with the audit report that Customs cash management systems and procedures had many shortcomings. Mr. Rob Wright informed the Committee about temporary measures Revenue Canada recently introduced to improve Customs' cash management performance. Further, Revenue Canada intends to completely rebuild its cash management systems as part of its five-year plan to re-engineer all its business processes, specifically the Department's plan to move Customs processes to the new Standardised Accounting Systems by year 2002 (31.30, 31.36, 31.39). The Committee therefore recommends the following:

That Revenue Canada introduce effective bank remitting system for Customs and also update Custom's systems in order to improve its ability to process large amounts of cash receipts. That these changes be ready to be implemented by the time Revenue Canada completes its re-engineering of all its business systems by year 2002.

The Auditor General found four areas of weakness (31.44) in Revenue Canada's revenue reporting systems and practices: systems, standards of performance, reconciliation, and analysis. The existing systems supporting the reporting of revenues are inefficient, disconnected and cumbersome (31.45). In order to obtain transaction and process information one must go to program branches in order get the required data from various feeder systems. The process of data collection is archaic, slow and labour-intensive which make even simple bookkeeping operations difficult to perform. In his Report, the Auditor General stated (31.45) that there is an urgent need to replace the existing feeder systems with automated data inputting systems. The Auditor General noted (31.46) Revenue Canada re-engineering efforts to remove inefficiencies caused by the disconnectivity of the current system by proposing to integrate client account information with information for assessing and for revenue reporting. The re-engineering also proposes to include an integrated general ledger, something that the current system does not have, and also moving from a cash basis of accounting to an accrual basis to support accounting for tax revenues (31.46).

The feeder systems that support the revenue reporting practices are of varying quality: some are quite labour intensive, while others are quite automated. The Audit revealed that input controls that ensure the accuracy or completeness of data, the timeframes required to clear unprocessed inventory or to follow up outstanding items are either inconsistent, incomplete or completely lacking. Customs and Excise is one area of particular concern, since its feeder systems are still largely manual, which makes its feeder systems archaic, slow and labour intensive. Already, the Department has taken certain steps to modernise its data capture systems. In its response to the Auditor General's Report (31.36), the Department formed a team in 1995 whose task was to look into the entire payment process systems at Revenue Canada, and to re-engineer it using the latest technology. The Committee learned that the Department is the process of replacing the current manual payment processing systems with automated systems using the latest scanning and imaging technology. Phase I of the new Payment Processing Systems (PPS) is scheduled for implementation in 1998. The Committee acknowledges the Department current efforts in updating its systems and therefore recommends:

That the Revenue Canada complete its updating of all its data capture and other information systems by the time it completes its re-engineering process by year 2002 and that it report its progress to Parliament.

The Auditor General Report stated (31.48 to 31.53) that the Department should perform accounting reconciliations on a more regular and timely basis in order to minimise errors to financial reporting and to derive assurance that systems and controls are performing as they should. Currently, the Department does not reconcile all revenues, offsetting payments and adjustments to amounts in central accounts on regular and timely basis, and it attempts a full reconciliation only once during the year end. Lack of full and timely reconciliation means that

Revenue Canada cannot provide complete assurance on the accuracy and completeness of the amounts by revenue stream for monthly and year end external report. In his Opening Statement to the Committee, Mr. Wright, indicated the Department's re-engineering efforts to move towards a new Standardised Accounting System which will align all departmental accounting practices.

In addition, the Auditor General stated that the Department should reconcile its central account balance to its taxpayer records (31.52). Such a reconciliation would capture all adjustments, transfers or cash transactions and provide the ultimate check that cash and revenue reporting are complete and appropriately represented by revenue streams. The Committee shares the same concerns expressed by the Auditor General and thus recommends the following:

That Revenue Canada execute all the required reconciliations to assure sound financial management; and

That Revenue Canada upgrade its systems to provide more automated tools to support revenue reporting and assure on a regular basis full reconciliation of revenues streams, and develop and apply performance standards for its feeder systems.

The Department of Finance requires that Revenue Canada provide it with more analysis and more timely analysis to ensure the quality and reasonableness of month-end and year end numbers provided for external reporting and to explain period-to-period fluctuations (31.54). Revenue Canada informed the Auditor General that the responsibility of analysis of the reasonableness of revenue reports is shared between Finance, Revenue Canada Departmental Headquarters and its program branches, with the program branches bearing most of the responsibility since many revenue details are found in the feeder systems. The Auditor General noted that there are no standards in place relating to the type and frequency of the routine analyses to be performed, or the kind of data required to analyse period to period fluctuations (31.55). Also, program branches are not provided with any instructions as to what constitutes a significant fluctuation requiring prompt investigation (31.56). So instead of initiating analyses, the program branches tend to respond to queries emanating from Headquarters or Finance. The Auditor General believes that the Department should routinely analyse key volumetric data which would provide better understanding of reasonableness of revenue fluctuations.

The Auditor General also observed that the Department does not provide program branches any criteria on the required degree of accuracy for the revenue stream being reported in such publications as the Fiscal Monitor and for Public Accounts (31.56). While terms of reference for revenue reporting matters exist between Finance and Revenue Canada, they are expressed in broad terms, without any specific guidance as to what constitutes a significant distortion in each revenue stream, nor does Finance communicate to Revenue Canada about the assumptions implicit in its revenue forecasts. This data could help Revenue Canada deal with interim or year-end reporting issues. It could also provide a better context to evaluate period-to-period revenue reports in terms of reasonableness and potential distortions.

In order to deal with reporting issues, the interdepartmental Fiscal Monitor Committee with representatives from Finance and Revenue Canada was set up two years ago (31.59). According to both departments, the Committee is a good forum for dealing with reporting issues and understanding respective needs and constraints. It is through this forum that questions on revenue fluctuations are raised by Finance for Revenue Canada's analysis and follow-up. Finance would like Revenue Canada to do more independent analyses and more timely analyses. In response, the Deputy Minister, Mr. Robert Wright, informed the Committee about a new revenue analysis unit that is scheduled to be fully staffed and operational by fall 1998 and that the Department is currently upgrading its program for the reconciliation of deposits to improve the accuracy of reporting revenues. The Committee also agrees that better co-ordination between departments is required in terms of timely analyses for identifying the causes underlying revenue fluctuations and thus recommends the following:

That Revenue Canada clarify expectations of program branches for analyses related to monthly revenue reports and that it should also provide them with threshold criteria regarding what constitutes significant revenue fluctuations to prompt investigative action; and

That Finance explicitly define the required levels of precision by type of revenue stream and provide Revenue Canada with economic assumptions underlying its revenue forecasts.

According to the Auditor General, recent government restraint initiatives have resulted in significant multiyear cuts in Revenue Canada's annual resources levels for regular workloads (31.76). The Department copes with declining revenue levels by concentrating funding reductions in administrative and program support areas. Other measures include offsetting funding reductions by savings generated from expected economies resulting from administrative consolidations and from a wide variety of business process engineering initiatives; and, finally, requesting additional resources from Treasury Board for any new work (e.g. new government priorities, tax policy initiatives, volume growth). Most funding issues are dealt with internally, and where absolutely necessary, referred to the Treasury Board.

The Auditor General noted that when making referrals for additional funding, Revenue Canada uses business cases to support its requests to the Treasury Board (31.83). Business cases are essential to the Department's process of obtaining funding for new work. The Auditor General found the business cases he examined to be qualitatively sound. But when it came to quantitative challenges, calculation errors or absence of satisfactory documentation were noted (31.88). A more rigorous quantitative challenge of business cases is needed as well as a system to monitor the use of funds and associated results received for specific purposes.

It was also noted that when the Department prepares its quantitative challenges, it does not apply consistently the effects of re-engineering and other business initiatives when estimating the costs for its requests for additional funding (31.89). Therefore the Committee recommends:

That Revenue Canada subject its business cases to more rigorous quantitative objective scrutiny.

The Auditor General's Report noted serious deficiencies in the Department's own budget and costing systems (31.91–.93). Recognising the importance of costing and budgeting systems for an organisation of the size and scope as Revenue Canada, the Committee therefore recommends:

That when completing its specifications for its new systems, Revenue Canada should ensure capture of complete, timely, relevant program production and expenditure costs.

The Report found many weaknesses in Revenue Canada's formal systems. Many of the formal systems were noted to be old in design, labour intensive, inefficient, and slow to generate information. Often the data generated by these systems are fragmentary and, in many instances, do not provide the information required for management needs. In some cases, data extraction requests require long execution times, longer if extraction requests involve complicated data manipulations. To compensate for the formal system's many shortcomings; management has to rely on proxy measures, informal information systems and other bridging practices.

As the Auditor General stated, there are few assurances on the quality and reliability of the data generated out of these systems (31.99, 31.100, 31.101). The Committee therefore recommends:

That Revenue Canada ensure and periodically review the integrity of information in its systems.

In terms of its overall financial management environment, Revenue Canada assigns top priority to meeting the basic legal requirement and government initiatives often at the expense of other priorities, particularly in responding to internal administrative needs and sound financial management practices (31.107). The Auditor General noted that the Department has made satisfactory progress in correcting for deficiencies observed in previous reports, but shortcomings remain and are starting to have a cumulative effect on the Department's operations and its ability to fulfil its mandate (31.15). Revenue Canada must continue corrective actions and give appropriate priorities to correct remaining deficiencies.

Financial management at the Department cuts across every business line and is part of every program; it is essential to its operations. The responsibilities for financial management is shared and decentralised among Headquarters, program branches and regional operations. Shared responsibility requires a clear accountability and a minimum fiduciary expectation. Given the diversity of business lines and the various programs operating within them, functional guidance, standards, overall review and co-ordination of financial management systems and practices are required. However, it was found that the internal audit was not being used effectively to provide overall assurance on the state of corporate financial management (31.121). Mr. Robert Wright told the Committee that Revenue Canada recently formed an internal audit committee to review all of the internal audit programs with the mandate of making the internal audit function more independent and effective. In response, the Committee therefore recommends:

That Revenue Canada continue to strengthen the role of internal audit to provide senior management with independent assurance on the state of financial management at the Department.

Several questions concerning the preparedness of Revenue Canada for the year 2000 / "Millennium Bug" were raised by the Committee. Revenue Canada's Deputy Minister, Mr. Robert Wright, informed the Committee that the Department was making good progress at modernising its systems to make them fully year 2000 compliant. The Deputy Minister said that most major programs were now year 2000 compliant and expected the Department to be fully ready by its target date of 1 January 1999, which leaves it a full year to test out systems and address any problems. Committee members expressed concerns on the Department's ability to deal with other non-compliant systems and the possible impact it might have on Revenue Canada's own systems. Mr. Wright indicated that all possible system interfaces are currently being examined in an effort to deal with this issue. Mr. Wright also proposed to present the Committee with the package Revenue Canada intends send to its client groups in order to assist them to become year 2000 compliant. Finally, The Committee queried the witness as to whether the proposed transition towards Revenue Collection Agency could cause delays in its implementation of new systems and procedures. Revenue Canada assured that the proposed move to Agency status would not put undue strain on its ability to proceed with the required changes to its systems, procedures and practices. The Committee therefore recommends:

That the Department complete its upgrading of all its major programs and systems to be year 2000 compliant by the target date of 1 January 1999 and that testing, validating and correcting of programs and systems be completed so that all systems are fully operational by 1 January 2000.

Conclusion

While the audit continued to observe some remaining deficiencies, notably in the areas of systems, procedures, reconciliation and analysis, it also commends the Department's serious intent and efforts to bring about the necessary changes to improve its financial management regime. The Committee encourages the Department to maintain the current momentum in order to address all outstanding issues regarding financial management.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 22 and 31)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Tuesday, 16 June 1998

Indian and Northern Affairs Canada

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

FOURTEENTH REPORT

The Standing Committee on Public Accounts has considered Chapters 35 and 36 of the December 1997 Report of the Auditor General of Canada (*Follow-up of Recommendations in Previous Reports - Indian and Northern Affairs Canada - On Reserve Capital Facilities and Maintenance — 1995, Chapter 23; Other Audit Observations - Escalating costs of on-reserve water supply projects not adequately justified and Lack of compliance with funding arrangements*) and the Committee has agreed to report the following:

Introduction

The on-reserve capital facilities and maintenance activity is an element of the Indian and Inuit Affairs Program administered by Indian and Northern Affairs Canada (the Department). It provides funding and support for Indian and Inuit communities to acquire, operate, and maintain basic non-residential facilities across Canada. The applicable budget for this activity for 1997–98 was \$806 million.

In Chapter 23 of his November 1995 Report, the Auditor General presented the results of his audit of the Department's management of the on-reserve capital facilities and maintenance activity. At that time he noted that the Department was devolving responsibility for the delivery of this activity to First Nations communities. The Auditor General observed that the Department had not identified and controlled areas of high risk and recommended a series of corrective measures. In its response, the Department agreed with the audit observations and indicated a willingness to take appropriate action. The Department reiterated these commitments in somewhat more detail in a letter to the Standing Committee on Public Accounts sent during the summer of 1996.

As an integral part of the audit cycle, the Auditor General reviewed the actions taken by the Department two years after the publication of the results of the original audit and presented his findings in Chapters 35 and 36 of his December 1997 Report.

The Committee believes that it is important to review the results of follow-up examinations conducted by the Auditor General. In this instance, because of the importance of this activity to First Nations' communities and its cost, the Committee decided to study the results of the follow-up. Accordingly, on 10 March 1998, the Committee met with Mr. Denis Desautels, the Auditor General of Canada, and Mr. Grant Wilson, Principal of the Audit Operations Branch, from the Office of the Auditor General. Mr. Scott Serson, Deputy Minister, and Ms. Cynthia Williams, Assistant Deputy Minister of Socio-Economic Policy and Programming and Program Redesign Sector, appeared on behalf of Indian and Northern Development Canada.

Observations and Recommendations

Following his review of the actions taken in response to his 1995 audit, the Auditor General reported that the Department had mostly focussed on internal studies and reviews. Actual results were disappointing. In terms of capital facilities projects, the Auditor General found "no significant improvements from key findings in 1995."

(35.248) He indicated that improvements are still needed in areas such as project risk assessments, monitoring, evidence of project completion and evaluation of project results. With regard to maintenance, the Auditor General reported that many fundamental problems remained unresolved. For example, he cited a 1997 departmental assessment showing that some First Nations lacked the training and expertise needed to maintain capital assets. Incentives to maintain these assets were absent and certain funding arrangements lacked a requirement for maintenance plans. The Auditor General pointed out, as well, that although responsibility for maintenance is being devolved to First Nations, not all of them have the capacity to identify their maintenance needs as required by the Department.

In June 1997, the Department issued draft compliance guidelines for the operation and maintenance of capital assets on reserves. The guidelines are meant to ensure that maintenance funds are spent for the purposes intended, that the conditions of facilities are assessed on an annual basis and action taken when needed, and that advice and assistance on maintenance are provided to First Nations. The Department expects that the guidelines will have been fully implemented for fiscal year 1998–99.

In his response to the Auditor General's observations, Deputy Minister Scott Serson told the Committee that "significant progress has been made on each of the Auditor General's five recommendations," and that "several initiatives are ongoing and [the Department] expect [s] full implementation within the next few weeks." In further testimony, he agreed to provide the Committee with a list of the Department's initiatives and the target dates for their implementation.

The Committee recognizes that the Department faces certain challenges in effecting change in this area. The Committee believes strongly, however, that a more concerted effort by the Department would have significantly minimized the problems revealed by the follow-up review. The Committee therefore welcomes the Department's commitment to fully implement — if belatedly — all of the Auditor General's recommendations within the very near future. In early June, Mr. Serson informed the Committee by letter that the Department has now put measures in place to address the Auditor General's 1995 recommendations. However, in light of the Department's record, the Committee, will require concrete assurances that these commitments have been achieved and are producing the intended results. Accordingly, the Committee recommends:

That Indian and Northern Affairs make every effort to attain the targets it has established for implementing the recommendations contained in Chapter 23 of the 1995 Report of the Auditor General of Canada;

That Indian and Northern Affairs Canada monitor implementation of the recommendations contained in Chapter 23 of the 1995 Report of the Auditor General of Canada and report the results to the Committee by 30 September 1998; and

That Indian and Northern Affairs Canada regularly include references to its management of the on-reserve capital facilities and maintenance activity in its annual *Performance Reports* to the House of Commons. These references must focus on the results achieved as a consequence of expenditures on this activity.

The follow-up uncovered two cases that the Auditor General told the Committee were "typical of some of the difficulties that relate to on-reserve infrastructure development." Rather than being isolated instances, Mr. Wilson confirmed similar cases could be found in other situations.

In the first case, the Department had given preliminary approval for a \$1 million for a new water supply development project. Estimated costs rose to \$2.3 million by April 1997.

The Department was aware, however, that the existing water supply system could have been repaired at an estimated cost of \$26,000. This would have avoided the need for a capital infrastructure project. The Auditor

General asserted, however, that this option was not given due consideration. Furthermore, the Auditor General found that although the Department had given \$30,000 to the community in question to implement the lower-cost solution, "no evidence was available in the Department to show what improvements had been made with these funds." (36.37). In his testimony before the Committee, the Deputy Minister was unwilling to claim that good value was achieved for the funds provided by the Department. This case demonstrates that the Department needs to do a better job of ensuring good value, monitoring projects and evaluating the results.

In the second case, the Auditor General found that the Department had approved an \$8.9 million project to be constructed by a First Nation without public tendering — in clear contravention of the funding arrangement between the Department and the First Nation that required public tendering for all construction contracts. The Auditor General told the Committee that "additional costs of up to \$1 million may have been incurred with questionable benefits."

Mr. Serson told the Committee that the Department has implemented a policy requiring First Nations to publicly tender all federally funded construction contracts worth more than \$500,000. Instead, however, of providing the Committee with the reassurance it was seeking that such cases will not occur again in the future, this statement gives rise to additional concerns. The Committee notes the following:

- The Department had a funding arrangement that required a public tender but did not enforce it. Instead, the Department permitted an \$8.9 million contract to be awarded without competition.
- The decision not to enforce the public tendering requirement was taken at the regional level and was not reviewed by the Department's senior management.
- The Deputy Minister stated, during testimony, that the Department tries "to encourage some creativity and flexibility" on the part of its regional offices with regard to the enforcement of tendering policies.
- The Auditor General reports that not all First Nations agree that bid tendering should be used to select construction contractors. (35.249)

Collectively, these factors strongly suggest that the Department may experience difficulty in obtaining compliance with its tendering policies.

An additional concern involves the \$500,000 threshold established by the Department to trigger a public tendering process. As the Auditor General indicated several times, this threshold is very high and is above that established for federal government agencies and departments when they issue contracts for construction and maintenance. The Committee shares this concern; assertions by Ms. Williams to the effect that the Department does not discourage First Nations from going to tender on projects valued at less than \$500,000 provide little comfort.

The Committee is of the firm belief that contracts for capital facilities projects and maintenance should be issued on the basis of rules that are clearly defined and communicated. The occasions on which such rules are modified should be extremely rare and subject to strict guidelines and review by senior departmental management.

The rules that apply to federal government departments and agencies — including Indian and Northern Affairs Canada — when they issue construction contracts are set forth in the Treasury Board Secretariat's Contracting Policy. These rules and the principles upon which they are based make an interesting contrast with the Department's policy on federally funded construction.

The Contracting Policy's objective is to carry out construction in a manner "that enhances access, competition and fairness and results in best value or, if appropriate, the optimal balance of overall benefits." The Policy states that government contracting shall be conducted in a manner that will "stand the test of public scrutiny

in matters of prudence and probity, facilitate access, encourage competition, and reflect fairness in the spending of public funds," and "support long-term industrial and regional development and other appropriate national objectives, including aboriginal economic development."

Under these rules, all projects valued at or above \$25,000 must be subject to a public tendering process.

The Committee believes that the rules guiding First Nations' tendering policies with regard to federally funded capital facilities projects must be similar to those to which the Department itself has to follow when it contracts construction services. The Committee therefore recommends:

That Indian and Northern Affairs Canada immediately amend its policy with regard to federally funded on-reserve construction contracts to state that all contracts must follow the public tendering guidelines established by Treasury Board Secretariat's guidelines.

Although it would prefer strict adherence to this policy, the Committee recognizes that in certain circumstances, a degree of flexibility will be required. Deviation from this policy must, however, occur only within the context of clearly established criteria and must be subject to review. The Committee therefore recommends:

That Indian and Northern Affairs Canada establish criteria that are strict and clear to govern deviation from its policy on federally funded construction contracts;

That Indian and Northern Affairs Canada establish a requirement that any deviation from its policy on federally funded construction contracts must be subject to review and prior approval at the assistant deputy ministerial level; and

That Indian and Northern Affairs Canada report and explain deviations from its policy on federally funded construction contracts to the Parliament of Canada in its *Performance Report*.

The Committee has some additional concerns about the potential for contract or project splitting. Although the Auditor General told the Committee that his audit had not uncovered any instances of this practice (1655), the Committee believes that measures need to be put in place to manage this particular risk. The Committee is also concerned that non-competitive sole-source contracts might be monopolized by a small number of contractors. It therefore recommends:

That Indian and Northern Affairs Canada closely monitor the contracting process for all federally funded on-reserve construction projects, regardless of value, and that it work closely with First Nations communities to ensure access, competition, fairness, and transparency, and best value or, if appropriate, an optimal balance of overall benefits in terms of the results.

Conclusion

The Committee was disappointed with the results of the follow-up review. The actions taken by the Department in response to the original audit were insufficient and slow. The two cases that were revealed during the course of the follow-up are proof of this.

The Committee fully expects that the Department will now make every effort to correct problems identified by the Auditor General some time ago. Actions taken on those recommendations as well as the Committee's should ensure that on-reserve capital facilities and maintenance is properly managed and that those living in First Nations' communities receive the full benefit of this vitally important activity.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 21 and 38)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Thursday, 8 October 1998

Office of the Superintendent of Financial Institutions: Insurance and Pensions

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

FIFTEENTH REPORT

The Standing Committee on Public Accounts has considered Chapter 30 of the December 1997 Report of the Auditor General of Canada (*Office of the Superintendent of Financial Institutions: Insurance and Pensions*) and the Committee has agreed to the following report:

Introduction

The financial industry is rapidly changing. The accelerated pace at which financial institutions are consolidating, technological advances and the ongoing development of interconnections between capital markets are resulting in a restructuring of the financial sector.

The Office of the Superintendent of Financial Institutions (OSFI) is a federal organization responsible for monitoring deposit-taking institutions, insurance companies and pension plans. On the whole, OSFI enjoys an excellent reputation among financial institutions and other regulatory agencies.

Since OSFI's inception in 1987, numerous changes have occurred in the financial industry and been made to the statutory provisions that govern it. OSFI has taken significant steps to adjust to those changes, in particular by placing greater emphasis on issues pertaining to solvency and good corporate governance to guarantee prudent management by the entities subject to OSFI supervision rather than to rely on compliance with statutes and regulations.

OSFI and other stakeholders, together with the financial industry, have developed sound codes of administrative and financial practice and guides to intervention for each of the sectors it regulates. OSFI continues to improve its regulatory framework by developing performance measures and new approaches to audit compliance with statutory and regulatory requirements.

An essential component of OSFI's success is its ability to adapt quickly to change. To meet these new challenges, OSFI must develop and maintain a strategic vision enabling it to revise its management strategy and framework to meet changing regulatory requirements over the long term. Although OSFI has managed to respond to the financial environment's present needs, it must nevertheless correct certain significant deficiencies in order to meet the needs of the future.

In view of the importance the federal government attaches to having efficient regulatory agencies, the Committee decided to consider Chapter 30 of the December 1997 Report of the Auditor General. On March 31, 1998, it met Mr. Denis Desautels (Auditor General of Canada), Mr. Ron Thompson (Assistant Auditor General) and Ms. Crystal Pace (Director, Audit Operations) from the Office of the Auditor General. The following individuals represented the Office of the Superintendent of Financial Institutions: Mr. John Palmer (Superintendent of Financial

Institutions). Mr. John Thompson (Deputy Superintendent, Policy Sector) and Ms. Edna MacKenzie (Assistant Superintendent, Corporate Services Sector).

Observations and Recommendations

The Auditor General noted in his report that OSFI is experiencing certain difficulties in its human resource management and planning: many key positions are vacant, it is difficult to retain most valued staff and there is a high staff turnover rate (30.30). As a result of these problems, OSFI has for the past two years been completely reviewing its human resource management framework in light of the requirements of OSFI's mission and strategic objectives. The result of this process of reflection has enabled OSFI to isolate three major issues that must be resolved: How to recruit and attract staff, how to retain valued staff and staff training and development.

Many Committee members were concerned by the human resource issues, particularly the need to establish a formal human resource management system at OSFI and how to recruit and retain valued staff. As regards to the human resource management system, the Superintendent of Financial Institutions, Mr. John Palmer, indicated that OSFI subscribed to the Auditor General's recommendations on the need to formalize and document OSFI's human resources strategy. At the time of the audit, OSFI was developing a draft strategic planning document which is expected to be completed in late spring 1998. The purpose of the document is to respond to the need perceived by the Auditor General to introduce a formal human resource strategic planning framework to link OSFI's human resource management activities with its vision of future developments in the regulation of the financial industry.

The Committee was informed by Mr. John Palmer that most of the major initiatives were still under way. The most time-consuming initiative is the so-called "universal classification", which consists in integrating 15 separate pay groups and 14 occupational groups. When the exercise is completed, OSFI hopes that the universal classification will give it more flexibility to assign employees to positions that make the best use of their abilities and to eliminate salary differences between various pay levels, which, in OSFI's view, is one cause of staff dissatisfaction.

The Committee also learned that OSFI was having problems retaining valued staff. More than ever, many of its new recruits are leaving OSFI after one or two years in the organization for more highly paid positions in private sector financial institutions. This phenomenon has resulted in a high staff turnover rate and some positions have remained vacant for long periods of time. Committee members questioned the witnesses to determine the causes of this high staff turnover rate. According to the Superintendent of Financial Institutions, Mr. John Palmer, the main cause was that OSFI's pay structure was not comparable with that provided in the private sector and that OSFI did not have all the flexibility it needed to adjust its pay scales in view of the limits imposed by the *Public Service Employment Act*. OSFI stated however that it was not seeking complete parity with the private sector, but rather to adjust the mid-ranges of its pay structure to become more competitive with the market. Mr. Palmer mentioned that OSFI was developing a proposal for the government to request adjustments to its pay structure.

Committee members nevertheless expressed certain reservations over OSFI's main approach, which is to readjust its pay scales so as to better retain staff. Some suggested that, instead of adjusting the pay structure, it would also be prudent to promote the organization's employee benefits, working conditions, training and development opportunities and job permanence or security. Other members went so far as to suggest inserting non-compete clauses in employment contracts or even adding conflict of interest guidelines to counter private sector raiding of OSFI staff. As a result, the Committee recommends:

That OSFI complete all initiatives concerning its human resources management system on time and that it regularly indicate in its annual performance report to Parliament the progress on these initiatives and indicate any developments that might slow down or undermine those initiatives; and

That OSFI conduct a thorough and well documented analysis to clearly determine the causes of its difficulties in retaining staff. Once the causes have been ascertained, that it thoroughly review all

components of the staff compensation system, including the pay structure, employee benefits, training and development programs, as well consider the possibility of including non-compete clauses in employment contracts, so as to be in a better position to retain staff.

The Auditor General observed that OSFI is a recognized leader in the regulation of financial institutions. By introducing its standards for sound business and financial practices and guides to intervention, developed in cooperation with its financial sector partners, OSFI has developed from a regulatory framework based on the compliance of statutes and regulations to a risk assessment and management system (30.7 and 30.8). In his report, the Auditor General observes that the system should be applied more uniformly (30.60). In particular, he describes cases in which OSFI was reluctant to inform a company of a change in its risk rating (30.61 and 30.90) out of fear that public disclosure of the change would undermine the efficiency and effectiveness of its work (30.61).

The Superintendent of Financial Institutions, Mr. John Palmer, wished to inform the Committee that there was no question of OSFI disclosing rating changes to the public, that OSFI was required by law to keep confidential information obtained from financial institutions and that it was impossible for OSFI to publicly disclose its conclusions based on that information. What OSFI fears the most is that financial institutions, which are not legally required to keep their ratings confidential, could disclose them to the public in order to secure an unfair competitive advantage.

The witness for OSFI, Mr. John Palmer, indicated that the ratings disclosure process could be better documented and informed the Committee about recent OSFI initiatives to inform financial institutions of changes to their ratings in a more uniform way.

One of the main initiatives is a thorough reorganization of OSFI to restructure the operations and policy sectors and to review the main mechanisms for monitoring financial institutions and developing regulatory policy. At the same time as the reorganization of its operations sector, OSFI intends to introduce a new form of monitoring and a new risk rating system based on the main risks to which financial institutions are exposed and on the controls they have established to manage those risks. The key components of the new monitoring method will be a standard evaluation of compliance with sound business and financial practices and a coherent implementation of the guides to intervention. This rating system review process is expected to be completed in two years.

The Superintendent of Financial Institutions, Mr. Palmer, then informed the Committee that OSFI currently has set up certain transitional measures for disclosing the results of its examinations of the financial institutions, without giving out overly specific information that the financial institutions could then disclose to the public. OSFI will arrange to be in a position to communicate ratings to financial institutions as soon as the new monitoring method is completed, in two years. In the meantime, OSFI hopes of the passage of appropriate statutory measures compelling the financial institutions to keep their ratings confidential. The Committee acknowledges OSFI's efforts regarding monitoring and disclosure of rates and recommends:

That OSFI pursue and complete its reorganization of its financial risk monitoring and rating systems as soon as reasonably possible; and

That OSFI regularly indicate in its annual performance report to Parliament the progress being made on this reorganization and indicate any developments that might slow down or undermine it. If public disclosure of risk rating is a genuine problem, that OSFI seek to have the act or regulations amended to prevent such disclosure.

Committee members also raised the question of the lack of actuarial resources and felt there should be better co-ordination between the work of OSFI's examiners, analysts and actuaries. The Superintendent of Financial Institutions, Mr. John Palmer, accepted the Auditor General's observations and recommendations and, in his address to the Committee, outlined the measures OSFI intends to take to correct the situation. The main initiatives amount to a thorough reorganization of OSFI, part of which will focus on the operations sector and should appreciably improve co-ordination of the work of analysts, examiners and actuaries.

The reorganization is expected to do two things for the actuaries. Some actuaries will be incorporated in monitoring groups and will be responsible for directly overseeing and examining insurance companies. Second, OSFI is currently forming a team of consulting actuaries who will support the control teams, show them how to better understand important actuarial issues and focus on certain projects that OSFI is conducting jointly with the Canadian Institute of Actuaries (CIA) to consolidate its actuarial practice because OSFI relies on the work of the actuary designated by the company to conduct its own actuarial analysis. OSFI intends to finish the reorganization by the end of the next fiscal year and to complete the actuarial component within three years. The slow pace of the consolidation is attributable to the fact that the Canadian Institute of Actuaries is an organization of volunteers and it is very difficult to set a deadline. In view of the above, the Committee recommends:

That OSFI continue and complete its reorganization and its actuarial consolidation as soon as possible; and

That OSFI regularly indicate in its annual performance report to Parliament on the progress being made on the reorganization and indicate any developments that might slow down or undermine it.

Lastly, the Committee questioned the witnesses on the financial industry's readiness for the year 2000 problem. The Committee was informed that, in the course of its annual examinations over the past two years, OSFI has been looking at the work done by the financial institutions to prepare their computer systems. OSFI is closely monitoring progress by the financial institutions and reviewing their plans to audit year 2000 readiness. Since OSFI is not an expert in the field, all it can state with any certainty is that the financial institutions and companies appear to be taking the necessary steps to prepare themselves. OSFI recognizes the need to expand and strengthen its knowledge of information technologies and thus intends to set up an expert group consisting of eight advisory groups by the end of the year. With this organization, OSFI hopes to take a closer look at the issue and to identify more clearly potential problems that may arise in preparations for the year 2000.

OSFI reported on its own year 2000 preparations. It has introduced a conversion program to replace all its computer hardware, approximately 400 microcomputers, with new bug-free equipment. This conversion should be complete by the end of 1998. In view of the above, the Committee therefore recommends:

That OSFI continue its follow-up and examination of the financial industry institutions it regulates and that it notify Parliament as soon as possible of any developments that could compromise the integrity of computer systems in the financial sector and compromise the assets of depositors, insurance policy-holders and pension plan members; and

That OSFI complete its own computer hardware conversion as soon as possible so as to be ready for the year 2000.

Conclusion

The Committee wishes to mention that the Office of the Superintendent of Financial Institutions has made significant progress in recent years to become a leader in the regulation of financial institutions and congratulates it on the initiatives it has taken to respond to the recent recommendations by the Auditor General of Canada.

The Committee has every hope that adoption of these recommendations and those of the Auditor General will help the Office of the Superintendent of Financial Institutions to continue its efforts to regulate the financial industry in the interest of the depositors, insurance policy-holders and pension plan members.

Pursuant to Standing Order 109, the Committee requests the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 25 and 40)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Thursday, 8 October 1998

Population Aging and Information for Parliament: Understanding the Choices

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

SIXTEENTH REPORT

The Standing Committee on Public Accounts has considered Chapter 6 of the Report of the Auditor General of Canada from April 1998 (*Population Aging and Information for Parliament: Understanding the Choices*) and has agreed to present the following report:

Introduction

In the next century, once the earliest members of the baby boom have reached normal retirement age, the growth rate of Canada's elderly population will be increasingly rapid while that of the active population will slow down markedly.

This general aging of the Canadian population could have negative effects on public finance. An older average population means greater pressure on public spending, in the form of higher pension payouts and demand for health-care services. Failing a major transformation of our patterns of work, this demographic change will put a considerable brake on the growth of the labour force, which will mean slower economic growth and thus lower public revenues. By the second decade of the coming century, when the full impact of the demographic change will begin to be felt, this combination of factors could have serious consequences for Canada's public finances, especially if Canada's debt load and taxation rates remain high.

Already many countries are paying attention to the impact of demographics on their public finances. For example, the United States and Denmark publish fiscal balance projections 40 to 50 years ahead. The United States, Argentina, New Zealand and Norway produce "generational" accounts, to give a long-term orientation to the budget process. The United Kingdom recently announced the introduction of a new fiscal stability code that provides for the formulation of financial projections over at least ten years, in order to shed light on the generational effect of the government's budget strategy.

The financial framework of the Canadian government is based on a short-term outlook horizon.

The federal government does take into account the possible influence of demographics on its public finances. It considered this question when it launched the pre-budget consultation process in the fall of 1997, without however specifically defining the possible future financial impact. In addition, during consultations on reforming the Canada Pension Plan (CPP), the federal government disclosed detailed financial information about the constraints facing the CPP in the years to come, in light of foreseeable demographic trends. To a lesser extent, the government has committed itself to a similar process for the reform of Old Age Security (OAS) and the Guaranteed Income Supplement (GIS). In the opinion of the Office of the Auditor General, the impact of demographic factors on the government's financial health should be determined for all aspects of government operations.

The purpose of analysing demographic trends when planning budgetary and fiscal projections is to obtain a clearer idea of the long-term consequences of each year's budget decisions.

It was in the context of these issues that the Standing Committee on Public Accounts decided to consider the findings and observations in Chapter 6 of the Auditor General's Report from April 1998, on population aging and information for Parliament. On June 9, 1998, the Committee met with Mr Denis Desautels (Auditor General of Canada), Mr Ron Thompson (Assistant Auditor General) and Mr Basil Zafiriou (Director, Audit Operations). The Department of Finance was represented by Mr Scott Clark (Deputy Minister), Mr Don Drummond (Assistant Deputy Minister) and Mr Peter DeVries (Director, Fiscal Policy, Economic and Fiscal Policy Branch).

Observations and Recommendations

In his introductory comments to the Committee, the Auditor General stressed the importance of communicating to parliamentarians and Canadians generally about the impact our aging population will have on economic activity in general and on public finances in particular. His aim was to explain the importance of giving Canadians a better understanding of the possible effects of demographic trends on the long-term situation of the country's public finances, and to demonstrate the links that exist between demographic trends and the current process of short-term budget decision-making.

According to the Auditor General, the value of demographic projections is not found in the numbers themselves (which are fraught with uncertainty) but rather that they compel people to think about the future impacts of short-term budget decisions. The goal is to introduce greater transparency in the budget process, however without making the government accountable for the accuracy of long-term demographic projections.

In his statement to the Committee, the Deputy Minister for the Department of Finance said that he is in full agreement with the conclusions found in the Auditor General's report; after all, good information is the foundation of good fiscal policy. Any disagreement centres on process. The Deputy Minister of the Department, Mr Scott Clark, expressed concern that the introduction of long-term forecasts would create unrealistic expectations about the government's ability to respect its own demographic projections and would distract it from the important objective of coping with short-term budgetary issues. The witness reminded the Committee that achieving long-term budget goals depends on the ability to achieve short-term budget objectives.

The federal government hesitates to publish long-term projections partly because of a desire to concentrate its attention on immediate problems, but partly because it fears being held accountable for achieving long-term projections, which certain people would consider as long range targets. Mr Clark used as an example the appearance of the Minister of Finance before the Main Estimates Committee to discuss the Department's budget. In his comments, the Minister alluded to the fact that the debt-to-GDP ratio in the United States was about 40 per cent and said it would be nice if Canada could have a comparable ratio. The next day, according to the witness, one of Canada's financial newspapers announced that the Minister of Finance was about to set a new debt target.

According to Mr Clark, the government's approach at the present time consists in establishing two-year mobile fiscal targets, which are then embedded in a medium-term fiscal framework. The first medium-term strategy anchor was the elimination of the budget deficit. Implicit in this objective was the need to halt the rise in the public debt and to put public finances on a sounder footing, so that the debt/GDP ratio could be kept on a permanent downward track. The Department is not planning to change this approach, which it considers as an effective formula in light of recent improvements in the health of Canada's public finances. The time may come, however, when longer-term fiscal projections again become part of the broader discussion of fiscal policy issues.

The Committee questioned the witness about the conditions that would lead the government to consider re-introducing long-term projections. Without describing any specific conditions, the Deputy Minister of Finance, Mr Clark, said he would like the government to build up more successes in meeting its short-term fiscal targets and to make public finances even healthier before thinking of introducing longer-term financial analysis.

The Committee, after hearing the comments and observations of the Auditor General and the representatives of the Department of Finance, proposes the following recommendations:

That the Department of Finance formulate a mechanism that the government could use to disseminate long-term demographic and fiscal information that would ensure transparency and greater understanding of the issue; and

That the Department of Finance report periodically to the Committee on the progress being made in this regard.

Conclusion

The Standing Committee on Public Accounts recognises that the Department of Finance has achieved success in placing Canada's public finances on a sounder footing. However, the Committee is of the opinion that it is becoming important to study demographic trends when planning fiscal and budgetary policy. Given that there is scarcely a decade remaining before the first waves of the baby boom arrive at retirement age, it is important that the federal government ensure that it will be able to continue to deliver essential public services to Canadians .

Measures taken in response to the Auditor General's recommendations and those of the Committee should be adequate to meet the concerns raised by the Auditor General's Report.

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 37 and 40)* is tabled.

Respectfully submitted,

John Williams

Chair

APPENDIX D

REPORT ON THE AUDIT OF THE PRESIDENT OF THE TREASURY BOARD'S REPORT TO PARLIAMENT:

TABLINGS IN PARLIAMENT FOR PARENT CROWN CORPORATIONS: ANNUAL REPORTS AND SUMMARIES OF CORPORATE PLANS AND BUDGETS

The *Financial Administration Act* requires the President of the Treasury Board to lay before each House of Parliament a report concerning the timing of tabling, by appropriate ministers, of annual reports and summaries of corporate plans and budgets of Crown corporations subject to the reporting provisions of Part X of the Act.

The report on these tablings allows Parliament to hold the appropriate ministers (and, ultimately, the Crown corporations) accountable for providing, within the relevant statutory deadlines, the information required under the *Financial Administration Act*. Accordingly, the report is required to indicate the time at, before, or within which the annual reports and the summaries of corporate plans, capital budgets and operating budgets (and amendments to them) were required to be tabled before each House during the reporting period; and the time they were actually tabled. The report on tablings is the responsibility of the President of the Treasury Board and is included in his annual report to Parliament, *Crown Corporations and Other Corporate Interests of Canada*, which is required to be tabled not later than 31 December (not tabled for 1998 at time of going to press).

As required by subsection 152(2) of the *Financial Administration Act*, I have audited the information contained in the President of the Treasury Board's report on tablings for the year ended 31 July 1998. Further, I am required to report on this audit in my annual Report to the House of Commons.

I conducted my audit in accordance with the standards for assurance engagements established by the Canadian Institute of Chartered Accountants. Those standards require that I plan and perform an audit to obtain reasonable assurance as to whether the report on tablings is free of significant misstatement. My audit included examining, on a test basis, the systems and procedures used by the Treasury Board Secretariat to monitor the tabling of the summaries and annual reports in each House of Parliament, and the information contained in the report. Accordingly, it included such tests and other procedures as I considered necessary in the circumstances.

In my opinion, the information contained in the report on tablings is accurate in all significant respects in accordance with the description of the Deadlines for Tabling in Parliament, disclosed in the report.

The following paragraphs are intended to highlight certain information that I believe may be of interest to members of the House of Commons.

This year's report on tablings identifies 73 instances of documents that were tabled late, relating to 16 of 40 Crown corporations required under the *Financial Administration Act* to table reports in the year. This represents approximately 20 percent of those documents that were required to be tabled and is similar to previous years.

Further, the report on tablings does not disclose that the following documents have not, as contemplated by subsection 122(1) of the *Financial Administration Act*, been approved by the Governor in Council:

- Atomic Energy of Canada Limited's corporate plans for 1995–96 to 1999–2000, 1996–97 to 2000–01, and 1997–98 to 2001–02; and
- Canada Post's corporate plan for 1997–98 to 2001–02 and its capital budget for 1997–98.

As a result, the related summaries of these documents have not been tabled in either House of Parliament.



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Assistant Auditor General
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Ottawa, Canada

16 October 1998

APPENDIX E

The Costs of Crown Corporation Audits Conducted by the Office of the Auditor General of Canada

Section 147 of the *Financial Administration Act* requires that the Office disclose the costs of preparing audit reports on all Crown corporations other than those exempted under section 85 of the Act (see Exhibit 1). An audit report includes an opinion on a corporation's financial statements and on its compliance with specified authorities. It may also include reporting on any other matter deemed significant.

The Office is also required by section 68 of the *Broadcasting Act* to report the cost of any audit report on the Canadian Broadcasting Corporation. For the fiscal year ended 31 March 1998, the full cost of the annual audit report was \$436,749.

Section 138 of the *Financial Administration Act* requires that, at least once every five years, each parent Crown corporation named in Schedule III of the Act undergo a special examination. This is distinct from the requirement for the annual audit of financial statements.

The objective of a special examination is to determine whether a corporation's financial and management control and information systems and its management practices provide reasonable assurance that:

- assets have been safeguarded and controlled;
- financial, human and physical resources have been managed economically and efficiently; and
- operations have been carried out effectively.

In 1997–98 the Office completed the special examination of five Crown corporations. The costs were:

Atlantic Pilotage Authority	\$ 153,629
Cape Breton Development Corporation	\$ 779,677
Farm Credit Corporation	\$ 741,930
Great Lakes Pilotage Authority	\$ 320,361
National Capital Commission	\$ 472,025

Exhibit 1

Costs of Preparing Annual Audit Reports for Fiscal Years Ending on or before 31 March 1998

Crown Corporation	Fiscal Year Ended	Cost Incurred
Atlantic Pilotage Authority	31.12.97	\$ 45,774
Atomic Energy of Canada Limited (Joint Auditor)	31.03.98	205,360
Business Development Bank of Canada (Joint Auditor)	31.03.98	177,583
Canada Deposit Insurance Corporation	31.03.98	135,793
Canada Development Investment Corporation (Joint Auditor)	31.12.97	31,147
Canada Lands Company Limited	31.03.98	138,874
Canada Lands Company (Vieux-Port de Québec) Inc.	31.03.98	426
Canada Mortgage and Housing Corporation (Joint Auditor)	31.12.97	187,504
Canadian Commercial Corporation	31.03.98	92,312
Canadian Dairy Commission	31.07.97	95,416
Canadian Museum of Civilization	31.03.98	75,416
Canadian Museum of Nature	31.03.98	87,761
Cape Breton Development Corporation	31.03.98	222,503
Defence Construction (1951) Limited	31.03.98	49,301
Enterprise Cape Breton Corporation	31.03.98	75,165
Export Development Corporation	31.12.97	334,139
Farm Credit Corporation	31.03.98	333,003
Freshwater Fish Marketing Corporation	30.04.97	121,203
Great Lakes Pilotage Authority, Ltd.	31.12.97	43,116
Laurentian Pilotage Authority	31.12.97	62,895
Marine Atlantic Inc.	31.12.97	223,648
National Capital Commission	31.03.98	221,334
National Gallery of Canada	31.03.98	79,427
National Museum of Science and Technology	31.03.98	61,187
Old Port of Montreal Corporation Inc.	31.03.98	77,262
Pacific Pilotage Authority	31.12.97	34,160
Petro-Canada Limited	31.12.97	12,499
Queens Quay West Land Corporation	31.03.98	29,216
Royal Canadian Mint	31.12.97	290,364
The St. Lawrence Seaway Authority	31.03.98	143,994
Seaway International Bridge Corporation Ltd.	31.12.97	39,868
The Jacques Cartier and Champlain Bridges Incorporated	31.03.98	73,348
Standards Council of Canada	31.03.98	43,213
VIA Rail Canada Inc. (Joint Auditor)	31.12.97	167,470

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